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Oil Politics in the New Iraq

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Oil Politics in the New Iraq

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Abstract

Oil Politics in the New Iraq

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Iraq is one of the world's major oil suppliers, and over ninety percent of its government revenues come from oil exports. Developing an oil management strategy that politicians from all sects and ethnic groups can agree on is therefore paramount to the future political and economic health of the Iraqi state. Yet the new Iraqi government cannot agree on a comprehensive hydrocarbons framework that would allocate oil ownership rights and share revenues eight years after the overthrow of Saddam Hussein. One major political battle preventing Iraq from developing its hydrocarbons industry is over the nature of federalism among all of the sects battling for oil wealth in Iraq. This paper focuses primarily on the issue between Kurds and Arabs, because the Kurds have actively promoted oil exploration. The Kurdistan Regional Government (KRG) is now a constitutionally-protected region, and has signed 37 production sharing agreement contracts with international oil companies. The federal government in Baghdad deems these contracts illegal. The KRG and Baghdad also cannot agree on the borders for the region, as both sides claim oil-rich Kirkuk. This paper analyses major developments in the KRG and Baghdad oil industries since 2003 and examines possible future scenarios for the country's oil sector. Drawing on international lessons learned from other oil-rich divided societies such as Nigeria, Sudan, Indonesia, and the United Arab Emirates, the paper suggest that oil ownership and revenue allocation should be decentralized to reduce secessionist pressure. The paper concludes with recommendations that the government needs to not only take care of obvious issues such as resolving ambiguities in the constitution and passing comprehensive hydrocarbons legislation, but it also needs to address export agreements and institute measures to ensure transparency. The KRG needs to develop its own oil industry, complete with access to export pipelines, and should be allowed to keep a higher percentage of KRG oil revenue over its current 17%. Iraq needs international mediation to resolve issues on Kirkuk and should also make innovative changes to the structure of its national oil company. These changes will facilitate the proper investing of oil wealth for future generations of Iraqis.

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Chapter One: Introduction

A. Problem statement

Iraqi Kurds and Arabs inherently disagree over the centralization of oil and gas in post-Saddam Iraq; to ensure economic growth via development of a federal oil industry, both sides must agree on a comprehensive legal framework that stipulates a stable and federal relationship between the Kurdish Regional Government (KRG) and the federal government in Baghdad. Oil export revenues generate over ninety percent of Iraq's government revenue, with foreign aid making up much of the remainder, so the financial future of Iraq depends on a functional, legislated agreement on how to manage its hydrocarbons.[1] Since the fall of Saddam Hussein's regime in 2003 and the writing of a new Iraqi constitution in 2005, governorates can form autonomous regions with wide-ranging powers of self-government over domestic affairs.[2] Kurds living in northern Iraq have used this new-found privilege to create the KRG, an autonomous region of Iraq consisting of three governorates: Dohuk, Arbil, and Sulaimaniya, with Arbil as its capital, as shown in Figures 1 and 2 in Appendix C. Kurds in the KRG have gained a level of political and economic autonomy that may allow the new regional government to manage its own oil industry independent of federal control.

Despite protests from the federal government in Baghdad, the KRG has signed contracts with approximately thirty-seven international oil companies (IOCs) to explore and produce its oil.[3] This is due in part to ambiguity in the constitution about the nature of Iraqi federalism, and also to the unfortunate reality that the parliament in Baghdad has

[1] Kane, Sean. "Iraq's Oil Politics: Where Agreement Might be Found." United States Institute for Peace. January 2010, page 9.
[2] Under Articles 110 and 115 of the Iraqi constitution. For a discussion of these articles, see Chapter 3, Section B3, below. The articles are also listed in full in Appendix B.
[3] Lando, Ben. "Parliament wants role in Iraqi oil deals." Iraq Oil Report. April 12, 2011. http://www.iraqoilreport.com/politics/oil-policy/parliament-wants-role-in-iraqi-oil-deals-5587/?utm_source=rss (accessed May 4, 2011).

been unable to pass a comprehensive legislative hydrocarbons framework.[4] Kurds also see this legislatively ambiguous moment as the opportunity to redress their historical oppression under Saddam's rule by generating their own revenue stream.

Resolving the issue of resource ownership and production is critical to the future of Iraq and to the global energy market.[5] With its vast and untapped oil reserves and estimated 143.1 billion barrels of oil, Iraq has the fourth largest oil reserves in the world.[6] That Iraq's hydrocarbons legislative framework is unresolved means that both sides still have a chance to establish a new social contract that reflects all parties' visions of the new Iraqi state. It has been eight years since the beginning of the U.S.-led Operation Iraqi Freedom, which overthrew Saddam Hussein's Baathist government, and six years since the constitution was signed; with each passing year, Kurds, Arabs, and IOCs are becoming further entrenched in their current positions, and a standstill looks more likely than a negotiated and mutually beneficial outcome. The unresolved balance between federal and regional control over oil and gas will therefore strongly influence the future of Iraqi federalism and of its political economy.

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[4] For a good overview, see Christopher M. Blanchard "Iraq: Oil and Gas Legislation, Revenue Sharing, and U.S. Policy." CRS Nov 3 2009 or Kane.

[5] Shankleman, Jill. "Managing Natural Resource Wealth." United States Institute of Peace Stabilization and Reconstruction Series. No. 4, August 2006. Page 3.

[6] Beehner, Lionel."Why Iraqi's Cannot Agree on an Oil Law" Council on Foreign Relations. 22 February, 2008. Some speculations about underdevelopment in the west and south of the country put Iraq's reserves at 215-245 billion, which would make Iraq 2nd only to or even with Saudi Arabia's 246 billion. Other estimates, such as BP's and EITI's are more conservative, at 115 billion barrels.

B. Brief history

1. Who are Iraqi Kurds?

The Kurdish civilization is over 4,000 years old and has been under Hellenic, Persian, and Ottoman control throughout its history.[7] Kurds number approximately thirty million, with a half of that population in Turkey and five million in Iraq (see Figure 3 in Appendix C). Under the British mandate, Kurds were under Arab rule from Baghdad. In the 1920 Treaty of Sevres, Britain guaranteed autonomy for what was then Ottoman Kurdistan but could neither find a Kurdish leader who could rise above tribal affiliations nor did they aspire to create a small state that may become loyal to the Russians.[8] Thus, the British signed an agreement in 1922 with Arab leaders in Baghdad to guarantee Kurdish rights within an Iraqi state.[9] The Treaty of Sevres was superseded by the 1923 Treaty of Lausanne, which divided Ottoman Kurdistan between Syria, Turkey, Iran and Iraq. When the British mandate in Iraq ended in 1930, there was no substantial accord to guarantee Kurdish autonomy. Kurds in modern-day Iraq are divided culturally, linguistically, and politically. The two major parties, the Kurdish Democratic Party (KDP) and the Patriotic Union of Kurdistan (PUK), overlap with tribal and linguistic splits. The KDP, under Barzani tribal leadership, live in the north and speak the Kurmanji dialect, which is written in Roman script. Those Kurds under Talabani tribal leadership generally belong to the PUK, live further east in Sulaimaniya and Kirkuk, and speak Sorani Kurdish, which is written in Arabic script (see Figure 4 in Appendix C). Through Kurmanji and Sorani are dialects of the same language, they are not mutually intelligible, and the Iraqi constitution stipulates only "Kurdish" as one of two official languages

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[7] Nisan, Mordechai. Minorities in the Middle East: A History of Struggle and Self-Expression. Jefferson: McFarland, 2002. 33.
[8] Ibid., page 37.
[9] Ibid., page 45.

alongside Arabic, not differentiating between the dialects.[10] The KRG also stipulates Arabic and Kurdish as its two official languages, glossing over difference between the two major dialects. Its policy is to "promote the two main dialects in the education system and the media."[11]

Although Kurds and Arabs fought together to overthrow the monarch in 1958, their friendship soured as the two sides vacillated between full self-determination versus autonomy within Iraq. The Kurds had a chance to sign a legal autonomy agreement in 1970, which would have created an autonomous region in Arbil, Dohuk, and Sulaimaniya, but negotiations broke down over the Arabization of Kurdistan (as part of a deliberate policy to make the area less Kurdish) and whether or not Kirkuk would become part of the Kurdish region, two issues that are still contested today. Kurdish support of Iran during the Iran-Iraq war angered Saddam, and he retaliated with the infamous Anfal campaign of 1988. Human Rights Watch estimates that this chemical weapons campaign killed 100,000 Kurds.[12] Kurds were subjected to more violence out of Baghdad during the 1991 Gulf War. Under Operation Provide Comfort, the United States established a no-fly zone above the 36th parallel to protect Kurdish Iraqis (see Figure 5 in Appendix C). After the war's end in 1992, the Kurds established a regional administration with Arbil as the capital, using donations from the US and the UN. The region's political governance broke down in 1994 when civil war broke out between the PUK and the KDP. The US brokered a settlement in 1998, but it was not even endorsed

[10] "Iraqi Constitution." October 15, 2005. http://www.uniraq.org/documents/iraqi_constitution.pdf (accessed May 4, 2011). Article 4.

[11] Kurdistan Regional Government. "The Kurdish Language." KRG.org. June 27, 2010. http://www.krg.org/articles/detail.asp?lngnr=12&smap=03010500&rnr=142&anr=18694 (accessed May 4, 2011)

[12] Katzman, Kenneth. "The Kurds in Post-Saddam Iraq." Congressional Research Service. September 1, 2009. Page 1.

until the Kurdish parliament reconvened in 2002 in anticipation of a US overthrow of Saddam.

Modern-day Iraqi Kurdistan does not encompass all of what Kurds perceive as their historical, territorial homeland (See Figure 5 in Appendix C for a map of the disputed territories). The KRG has de facto, but not de jure control of the hashed area on the map, which includes Kirkuk and its 15-billion barrel, super-giant oil field.[13] Citizens of the governorate are to vote on whether they want to join the KRG or remain as an independent governorate under Baghdad's control; however, the referenda have been delayed multiple times. Kirkuk's unclear status complicates any agreement on oil production and revenue allocation.

2. Iraqi oil under Saddam

The oil industry was under national control from 1972-2003; Iraq made only minimal investments in infrastructure and technology, and the poor state of repair was compounded by crippling economic sanctions that limited international investment. Certain regions of the country, such as the Kurdish north, were systematically overlooked for production capability, so the region's current resources are not well known. During the UN Oil for Food program, which lasted from 1995 to 2003, the UN was the sole trustee of Iraqi oil. The KRG received thirteen percent of Iraq's oil revenues during this period, but complained they were not receiving their fair share.[14] Due to the limit placed on exports during this period, Iraqis began smuggling oil via Jordan, Syria, Lebanon, Kuwait, Saudi Arabic, and Turkey.[15] Each region and export route was controlled by a

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[13] Hilterman, Joost R. "Kirkuk as a Peacebuilding Test Case." In Iraq: Preventing a New Generation of Conflict." Markus E. Bouillon, David M. Malone, and Ben Rowswell, Eds. Boulder, 2007. Pages 125-142.
[14] Gunter, Michael M. and Hakan Yavuz. "The Continuing Crisis in Iraqi Kurdistan." Middle East Policy. Vol. 12, No. 1, Spring 2005. 122-133.
[15] Raphael Israeli. The Iraq War: The regional impact on Shi'ites, Kurds, Sunnis, and Arabs. 2004. Page 141. For more information about the organized crime rings that control oil smuggling, see Joel Wing's

particular tribe, and sometimes by major front companies.[16] For example, senior leadership in the Barzani clan helped Saddam smuggle oil out through a northern route in Turkey via Dohuk and Zakho, which earned those responsible several million dollars a week.[17]

Post-Saddam Iraq is still struggling to provide safety and services for its people. Oil and gas pipelines, installations, and personnel have been targeted 469 times since March 2003, and the legal status of pre-existing oil contracts is nebulous.[18] Iraq's lack of security and strong political leadership may also mean that reforming the oil and gas industry is not on the government's short list of priorities, despite its long-term importance.

C. OUTLINE OF PAPER

This report seeks to answer the question of how a newly federal Iraq can best manage its hydrocarbons resources among competing Kurdish and Arab political and sectarian interests. Chapter Two is a literature review that focuses first on oil management strategies, both on issues of who owns oil resources as well as how countries allocate revenues from oil sales. The chapter also focuses on production sharing agreements (PSAs), the contract type that the KRG has chosen to negotiate with IOCs. The contracts provide favorable terms to IOCs to compensate the investor for risk while providing the producer country shared profits. The chapter then focuses on ethnic conflict literature,

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blog, "Musings on Iraq," at http://musingsoniraq.blogspot.com, specifically "A history of oil smuggling in Iraq."Mr. Wing estimates that oil smuggling costs Iraq at least $1 billion/month.

[16] Central Intelligence Agency. "Iraqi Oil Smuggling." Iraq WMD 2004 Report Annex F. https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxF.html (Accessed May 4, 2011).

[17] Anderson, Liam and Gareth Stansfield. The Future of Iraq: Democracy, Dictatorship or Division? New York: Palgrave Macmillan, 2004. Page 174.

[18] Brookings Institute. "Iraq Index: Tracking Variables of Reconstruction and Security in post-Saddam Iraq" Februrary 25, 2011. http://www.brookings.edu/saban/iraq-index.aspx (Accessed May 4, 2011). Page 17.

particularly on the division of natural resources among ethnically divided societies. International case studies from Nigeria, Sudan, the United Arab Emirates, and Indonesia provide useful lessons for Iraq's oil sector. In particular, these cases offer guidance on whether or not decentralization is a successful approach for ethnically divided societies.

Chapter Three discusses problems with Iraq's post-2003 oil and gas management strategies. The chapter first identifies key players and stakeholders. While the Kurds are the most visible minority, tensions also exist between Sunnis and Shiias that could be resolved in part by comprehensive hydrocarbons legislation. A comprehensive settlement would set a precedent for the balance of power between Iraq's regions vis-à-vis the federal government and would also ensure an equitable revenue stream for all groups in Iraq (such as between governorates, regions, religious sects, and ethnic groups). The nature of federalism in post-Saddam Iraq is still an unresolved issue, and not only between the KRG and Baghdad. While the KRG stepped out in front as the first group to become a region, the KRG-Baghdad dispute over balance of power could have implications for other Iraqi peoples as well.

The chapter then discusses the major weaknesses of the current system preventing Iraq from moving forward. In addition to having a vague constitution, Iraq's supporting legislation about hydrocarbons is problematic, due in part to the U.S.'s involvement in writing the draft laws during the 2003-2004 Coalition Provisional Authority (CPA) period. The delay in passing comprehensive hydrocarbons legislation is due in part to the U.S.'s encouragement that Iraqis adopt policies favorable for IOCs. The draft hydrocarbons and revenue sharing laws have been held up in Iraq's Council of Representatives (parliament) since 2007. Even in 2011, there is currently no federal legislative framework in place for Iraq's oil and gas resources. For example, one of the laws awaiting approval would reconstitute the Iraqi National Oil Company (INOC), since the enabling legislation for INOC was repealed in 2003. Another obstacle to passing this legislation is political disagreement between the KRG in Arbil and the federal government in Baghdad over the nature of Iraqi federalism in relation to the management of the oil and gas sector; the KRG wants Baghdad to play a more limited role in ownership and allocations, ceding more control to IOCs and financial institutions, whereas Baghdad wants stronger national control. Additionally, the constitution states that oil money should be divided by population, which requires a new census, but all parties are fearful of the outcome. If a new census shows drastic population changes for any sect or ethnic group, that group's claims to oil revenue and disputed territories would shift drastically. For example, the politically dominant Sunnis, who are also a minority and without much oil resources, would be impacted significantly and negatively if their numbers shrink.[19] Because of the political stalemate in Baghdad, the KRG has used its increased political autonomy within a federal Iraq to advance its own economic interests. This has led to significant changes in the KRG's political economy, with the development of its oil industry as the most visible example.

Chapter Four is an analysis of oil politics in post-Saddam Iraq. There are a number of major problems that are preventing Iraq from managing its oil effectively. These problems include Kurdish aspirations for autonomy, problems with the draft hydrocarbons laws, and constitutional ambiguity. The uncertainty over who owns and benefits from Iraq's oil is part of a larger debate over the power of autonomous regions vis-à-vis the central government. Kurds want to take advantage of this period of legal ambiguity to earn revenue and increase their political and economic bargaining power. Baghdad is firm about central control. A final problem is that politicians still cannot

[19] This is a likely outcome. More affluence and connected Sunnis fled during the war than either Kurds or Shiias, who were either excited about the political changes less well off.

agree about the exact boundaries of Kurdistan. Both sides would like to claim power over the oil-rich Kirkuk governorate. But instead of dealing with major problems head-on, politicians have delayed important decisions such as conducting a census, or pressing forward with UN-sponsored talks about the future of Kirkuk.

Given these obstacles, a continuation of the stalemate status quo is more likely than either a negotiated settlement or a descent into violent conflict or civil war. The implications of a continued stalemate are that IOCs will become further entrenched in the KRG, making any changes to the contracts and the exploration and production system harder to achieve. Additionally, illicit smuggling may increase via Iran, which deprives Baghdad from a share of any revenues. Increased sectarian tensions as a result of a continued stalemate could mean that the KRG gets reduced federal budget allocations from its current seventeen percent.[20]

Chapter Five presents policy recommendations to address both legal and political issues facing Iraq's oil and gas industry. The chapter pays special attention to incremental reforms that the government could implement in the short-term that will diffuse sectarian and secessionist tensions. These include increasing transparency, scenarios to resolve the Kirkuk issue, and training Iraqis to work in and benefit from the oil industry.

[20] This is a population estimate, which increased from 13% during the Oil for Food Program to its current 17%. Katzman 10.

Chapter Two: Literature review

Oil rich states have classic characteristics that create problems with good governance. These problems are compounded when competing groups in a society are competing for oil rents. Many oil-rich states, or rentier states,[21] are authoritarian and are stubbornly resistant to democracy, as M. Ross shows in his 2009 "Oil and Democracy Revisited."[22] Ross spells out the causal link between economic rents and authoritarianism; namely, oil-rich states tend to be high-spending, low-tax, and have weak "social organizations that might otherwise counterbalance the state's power." [23] The high spending allows the state to more easily buy support and offer popular programs like gas and food subsidies. The low taxation lowers pressure on the government to be transparent by reducing the public's desire for democratic accountability. These tendencies common to oil-rich states may work against Iraq's becoming an effective democracy. Given this background, Robert Springborg's 2007 *Oil and Democracy in Iraq* contributes to the policy debate about options for Iraq's oil industry in an effort to avoid common economic and political pitfalls that accompany sudden oil wealth in poor nations, such as Dutch Disease and authoritarianism.[24]

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[21] A rentier state is one that derives a significant portion of its revenues from oil rents. An oil rent is the difference between the price of extracting a good (i.e., $2/barrel) as compared to payments received for the good (i.e., $100 for a barrel on the international market.)

[22] Ross, Michael. "Oil and Democracy Revisited." 2009. Draft version available online at http://www.sscnet.ucla.edu/polisci/faculty/ross/Oil%20and%20Democracy%20Revisited.pdf (Accessed May 4, 2011). Page 2.

[23] Ibid., pages 19-20.

[24] Dutch Disease is a phenomenon in which currency appreciates due to national dependence on resource revenue from a single commodity. This makes other industries less competitive and makes the national economy vulnerable to commodity price fluctuations.

A. Oil Management

1. Ownership

Good oil management strategies in Iraq could avoid or mitigate these authoritarian pitfalls. Oil ownership refers to who assigns subsurface rights, regulates exploration, and captures the economic rents from oil, or the difference in the actual cost of the oil extraction as compared to the value paid for oil.[25] Robert Springborg sees four major options for Iraq to manage ownership of its oil resources (see Table 1, below). Until 2003, Iraq's oil was publically and centrally owned by INOC, which regulated any foreign involvement using service agreements or license agreements. Under this traditional model still used by most Gulf countries, the state typically holds a bidding process and grants IOCs the right to explore, produce, export, and sell its oil for a limited amount of time. Service agreements retain the highest level of state control, and the state pays the IOC a fixed amount for services rendered. With a contractual license agreement, the IOC pays royalties or concessions to the state as fixed percentages of the oil's value, but the state retains ownership of the oil.[26] Arab Sunnis and Shiias are hesitant to move very far away from this model. Kurds, on the other hand, want decentralized ownership of their oil and an increased measure of control and distance from Baghdad. The KRG is willing to privatize oil ownership at least partially by ceding control to foreign companies through PSAs. "Unbundling" INOC, or breaking it down into component parts, and then privatizing segments incrementally would be one way to maintain state ownership in a highly nationalist context while still benefiting from the private sector's specialized expertise. Algeria successfully unbundled its national oil company, Sonatrach, into

[25] Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Pages 4-5.

[26] Radon, Jenik. "How to Negotiate an Oil Agreement." In Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Page 99.

fifteen components and partially privatized some companies, although Sonatrach maintains its nationalist oil monopoly by keeping at list fifty-one percent of the shares.[27]

Table 1: Oil ownership[28]

	Public	Private
Centralized	INOC (national oil company)	INOC privatized to anchor investor(s) or PSAs
Decentralized	Ownership by province/region or sector ("un-bundling")	Privatized by subsector or region or unbundling

Production sharing agreements

PSAs are a long-term oil contract designed to compensate the IOC for taking on risk. These contracts are common in situations where the extent and type of oil resource is unknown, where the IOC will have to make large up-front expenditures for infrastructure, or where the geography makes extraction potentially expensive and difficult. These concerns reflect the situation in the KRG;[29] IOCs had to make upfront infrastructure investments and were doing so in a risky environment. Under a PSA, the IOC agrees to pay for initial infrastructure developments and cover the costs of exploration. In return, the IOC keeps the initial cost oil to recoup its investment. Subsequent oil extracted is called profit oil and is split between the country and the IOC (at a percentage designated in the contract). This profit-sharing mechanism (as opposed

[27] Springborg, Robert, Ed. Oil and Democracy in Iraq. London: SAQI Books, 2007. See pages 83, 93, and 108 for information about how Mexico and Algeria approached unbundling their NOCs.
[28] Ibid., pages 76 and 110.
[29] International Crisis Group. Oil for Soil: Toward Grand Bargain on Iraq and the Kurds. Middle East Report No. 80. October 28, 2008. Page 14.

to compensation for services rendered) is the major contractual difference as compared to service agreements.

2. Revenue allocation

Regardless of which party owns the oil and what type of contract the country decides to use, countries still have to decide how to allocate any oil revenue that remains in state hands. Springborg uses the same public-private, centralized-decentralized categorization to formulate options for Iraq. Under the public, centralized allocation model, the state collects all revenue and spends it on social and infrastructure projects. This is the traditional Middle East and North Africa (MENA) model, and Iraq under Saddam Hussein hypothetically allocated its revenue this way. Post-Saddam Iraq is most likely moving towards a public, decentralized model in which the KRG and the federal government each share a portion of their revenue with the other. Kurds also prefer that a private, international financial institution takes over revenue allocation duties, rather than the Central Bank of Iraq, but Baghdad is equally as opposed to moving money abroad.

Table 2: Allocation – how will the revenues be distributed?[30]

	Public	Private
Centralized	Natural (non-renewable) resources; social safety nets	National trust with investments/ loans to private companies
Decentralized	Revenue sharing with provincial/ local governments	Pension or other direct payment scheme

Jeffrey Sachs, writing in *Escaping the Resource Curse*, favors the public, centralized allocation model for low-income countries, arguing that states should reinvest

[30] Springborg, page 39.

oil revenue to develop public programs that can have a multi-generational effect.[31] Even though the idea of handing money out to individual Iraqis is attractive to many scholars (see below), Sachs and Terry Lynn Karl are cautious and believe this step is premature. Karl, in her contribution to *Escaping the Resource Curse*, is generally in favor of a public, centralized natural resource fund like Norway's. The goal of Norway's oil fund is to save excess money during years of high oil production or prices, insulate the oil money, and spend on socially productive investments. Karl acknowledges that Norway's highly developed governance systems and social cohesion make these goals more feasible in Norway than they would be in Iraq.[32] She argues that good governance is a prerequisite to using petrodollars effectively. The question then becomes which allocation system is most likely to promote good governance in Iraq.

Many experts on Iraq argue that handing out money to individual citizens is the best way to improve Iraqis' lives quickly. Writing in *Foreign Affairs*, Birdsall and Subramanian favor a private, decentralized payout scheme similar to the Alaska or Alberta, Canada model.[33] They say that such a pay-out scheme will ensure the most equitable distribution, reduce state corruption, and also help develop financial systems by encouraging Iraqis to open bank accounts. The authors see this one-generation pay-out as having multi-generational effects; if parents have extra income, they can immunize their children and send them to school, which will put Iraq on better footing going forward. [34]

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[31] Sachs, Jeffrey D. "How to Handle the Macroeconomics of Oil Wealth." In Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Page 176.
[32] Karl, Terry Lynn. "Ensuring Fairness: the Case for a Transparent Fiscal Social Contract." In Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Page 271.
[33] Birdsall, Nancy and Arvind Subramanian. "Saving Iraq from its Oil." Foreign Affairs. Jul/Aug 2004.
[34] Ibid., page 83.

The major impediment to citizen payout scheme is the weak capacity of the Iraqi state. Only nine percent of Iraqis have bank accounts, and the lack of a regular census means that the state can only estimate the number of citizens it has or how to contact them.[35] While a strict division of revenue by population may be the most equitable system, it does nothing in Iraq to address inter-sectarian grievances between Kurds, Sunnis, and Shiias. A strict allocation by population also fails to address whether the provenance of the oil would change the allocation formula, i.e., whether Kurds would get more money from KRG oil.

Springborg warns that decentralization has dangerous political implications if it strengthens regions too far. If Kurds have too much control over oil ownership and revenue allocation, this can strengthen their secessionist tendencies and destabilize a federal Iraq. Haysom & Kane argue the reverse; if natural resources are asymmetrically allocated, the state should give special authority to specific states or provinces to deflate secessionist tendencies.[36] Most likely, Iraq will end up with a hybrid model that combines some elements of both central and decentralized revenue allocation. Joseph Bell argues that some money could be placed in a separate account (as has been done in Norway) which could be held in Iraq or in an offshore account, and that elected officials could use the remainder as part of their annual national budget.[37] This arguments lead into the academic debate on how to best divide natural resources among ethnically divided societies.

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[35] Carter, Wes. "Iraqi Business Leaders gather at Balad."U.S. Air Force. April 5, 2010. http://www.af.mil/news/story.asp?id=123198293 (Accessed May 4, 2011).

[36] Haysom, Nicholas and Sean Kane. "Negotiating Natural Resources for Peace: Ownership, control and wealth-sharing."Center for Humanitarian Dialog Briefing Paper, October 2009. Page 17.

[37] Bell, Joseph C. and Teresa Maurea Faria. "Critical Issues for a Revenue Management Law. in Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Page 288.

B. Allocation of Natural Resources in Ethnically Divided Societies

Oil-rich societies are prone to civil conflict or war between societal groups, particularly to secessionist civil war. Because warring factions often overlap with ethnic boundaries, these conflicts manifest themselves as ethnic conflict.[38] Collier and Hoffler find that secession is more likely if the secessionist group perceives an economic advantage from becoming independent. Resolving conflict in these divided societies is approached through decentralized oil management, federalization, or autonomy.[39] Before focusing on Iraq in the remainder of the paper, this chapter will take a brief look at several other divided countries' experiences with oil management, namely Nigeria, Sudan, the United Arab Emirates, and Indonesia. Chapters Four discusses these countries again in terms of relevant lessons for Iraq's oil management between Kurds and Arabs.

1. Nigeria

Nigeria is, in many respects, the model of what to avoid. Since the discovery of oil in the 1960s, inequality and poverty have increased sharply, and the country has experienced ten military coups (six of them successful) and thirty years of military rule.[40] After the oil discovery in the southeast (see Figure 6 in Appendix C), the residents of the southeastern Biafra region, the Igbo, felt neglected. Seeking improved economic benefits, the Igbo seceded and created the Republic of Biafra (see Figure 7 in Appendix C). Civil war lasted from 1967 to 1970, at which point the federal government adopted a revenue sharing strategy to diffuse secessionist pressure.

The Nigerian federal government adopted a public, centralized oil management strategy with a decentralized revenue allocation system. Under Petroleum Decree

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[38] Collier, Paul and Anke Hoeffler. The Political Economy of Secession. December 23, 2002.
[39] Wolff, Stefan. "Approaches to Conflict Resolution in Divided Societies: The Many Uses of Territorial Self-Governance." Exeter Center for Ethno-Political Studies. November 2010.
[40] Birdsall & Subramanian, 82.

Number Five of 1969, “ownership and control of all petroleum in under or upon any land… is vested on the federal government of Nigeria.”[41] The national parliament has exclusive legislative authority over mines and minerals, including hydrocarbons.[42] Every five years, the parliament decides on the formula for revenue distribution, with at least thirteen percent going to the oil-producing state.[43] For the remainder, parliament comes up with a formula based on population, internal revenue generation of the individual region, and land mass.[44] Each regional government gets a fixed amount of oil revenue plus an additional amount for population, which has led to a proliferation in the number of identity groups in Nigeria; the state recognized three regions in 1970, and now recognizes thirty-six, each of whom receives individual allocations.[45] The reason for this increase is not merely an assertion to historic rights of self-government, but rather economic. If a region is further divided, the population gets the same amount based on its numbers plus an additional fixed amount. The increase in number of regions is therefore not a reflection of ethnic salience but of using identity politics to obtain oil rents.

2. Sudan

As in Nigeria, oil was discovered in Sudan in the 1960s. Most of the unexploited oil is in the south, with many current oil fields on the border between the Arab north and the relatively autonomous (and soon-to-be independent) Christian south (see Figure 8 in Appendix C). The southern Sudan People’s Liberation Movement (SPLM) claimed that the government of Sudan was controlling oil money without providing and benefits to local populations. The two sides warred from 1983 to 2005, at which point they wrote a

[41] See Article 44 of the Nigerian constitution. Haysom & Kane, Page 11.
[42] Ibid., page 14.
[43] Ibid., page 22
[44] See Article 162.2 of the Nigerian constitution.
[45] Collier & Hoeffler, page 19.

new constitution and a comprehensive peace agreement (CPA) consisting of six protocols. The agreement on wealth sharing is one of six protocols and outlines a 50-50 revenue sharing split between north and south, with two percent reserved for the specific producing area.[46] The CPA explicitly delayed the issue of who owned the oil, since the political future of Southern Sudan was uncertain at the time of writing.[47] The CPA also established a national petroleum commission to ratify and approve all oil contracts in the whole country. The commission includes five representatives from the south, five from the north, and three from region where the oil concession is located.[48]

The CPA arrangement may all soon change since Southern Sudan voted to become an independent nation in January 2011. Oil revenues currently account for ninety-eight percent of Southern Sudan's budget, so ensuring continued access is pivotal to that nation's future.[49] An issue still to be determined is where to draw the 1,250 mile border between the two states, since many oil-rich areas, such as the Abyei region, lie on the border (see Figure 8 in Appendix C). Much like Kirkuk in Iraq, the referendum to determine whether the majority-Christian Abyei would join the North or the South, has been delayed. South Sudan is now landlocked and has a vast amount of unexploited oil with no obvious export route except via the North. To pipe its oil out to the Red Sea, it will have to negotiate with the (northern) Sudanese government. The CPA revenue sharing plan may continue as is, or all parties may renegotiate so that the South pays the North transfer fees. Southern Sudanese have also explored the idea of building a new pipeline out through Kenya, but probably do not have the necessary funds.[50] This

[46] Haysom & Kane, page 21.
[47] Southern Sudanese voted for full sovereignty in a January 2011 referendum.
[48] See the wealth sharing protocol in Article 3.2 of the CPA. Haysom & Kane, page 14.
[49] The Economist. "South Sudan's future: Now for the hard part." February 5, 2011.
[50] Ibid.

proposal demonstrates the degree to which the new nation desires to be free from the North and to profit from its own oil.

3. The United Arab Emirates

The United Arab Emirates (UAE) consists of seven distinct emirates, of which Abu Dhabi and Dubai are powerful economic actors on the world stage (See Figure 9 in Appendix C). When the seven emirates decided to form the UAE in 1971, they agreed that Abu Dhabi and Dubai would support the other five emirates economically in return for political support of the overall union. Since ninety-four percent of the UAE's oil is located in Abu Dhabi (see Figure 10 in Appendix C), this case study focuses on the Abu Dhabi National Oil Company's (ADNOC) oil management strategy.

Like the KRG, Abu Dhabi did not enter the oil market until relatively recently and learned from other countries' strategies. Abu Dhabians, like Iraqi Kurds, had a lack of technical expertise and commercial knowledge.[51] Abu Dhabi therefore decided not to completely nationalize its oil; instead, the state has a controlling share of sixty percent in ADNOC, and foreign companies can keep minority shares; ownership is thus a mix of public and private. Oil ownership is decentralized, as outlined in Article 23 of the constitution, which states that the natural resources and wealth in each Emirate is considered to be the public property of that Emirate. [52] According to Valerie Marcel, management is a local issue, not a federal UAE issue. "High strategy decisions are made by the government (that is to say, the ruler), and these are executed by the NOC… there is no need for government 'interference' in ADNOC's operations."[53] The government of

[51] Rai, Varun and D.G. Victor, "Awakening Giant: Strategy and Performance of the Abu Dhabi National Oil Company (ADNOC)" in Oil and Governance: State-Owned Enterprises and the World Energy Supply. Cambridge University Press: New York, forthcoming 2012. Page 7.
[52] Haysom & Kane, page 11.
[53] Marcel, Valerie. Oil Titans: National Oil Companies in the Middle East. Brookings Institution Press: Washington, 2006. Page 86.

Abu Dhabi used its initial oil money in the 1970s on schools, hospitals and roads. It also created a sovereign wealth fund to save for future generations and has only moderate plans for expansion.[54] The centralizing counterbalance is that each emirate, including Abu Dhabi, is required to contribute a negotiated portion of its annual revenue to the Union Budget.[55]

The major difference between Abu Dhabi and the other countries presented here (including Iraq) is Abu Dhabi's political stability and lack of competing claims for land. The al-Nahyan family has long ruled the emirate, and its economic dominance over the other six emirates enabled long-term decision making. A small group of managers on the Supreme Petroleum Council, Abu Dhabi's' main oil policy body, makes all decisions regarding oil. Sheikh Khalifa is the chair of the council, and he inherited the position from his father, Sheikh Zayed.[56] The council informs ADNOC what to implement, and there are no strong competing interests.[57]

4. Indonesia

Aceh is a far-western territory of Indonesia (see Figure 11 in Appendix C). The central government started extracting oil in 1974, and the Acehnese felt exploited and oppressed because the government kept oil rents in Jakarta. The Acehnese wanted self-determination and formed the Free Aceh Movement (GAM), an insurgent group with an armed wing that fought the Indonesian military in small skirmishes from 1975 until 2005. The Indonesian state was determined to stay centralized and put the military in place to

[54] Rai, page 14. Marcel, pages 175-6.
[55] See Article 127 of the Constitution of the United Arab Emirates as reprinted in Haysom & Kane, page 22.
[56] Marcel, page 104.
[57] Rai, page 15.

protect the fields.[58] The federal government in Jakarta continued to manage its oil publicly and centrally. Article 33.2 of its constitution states that "the land, the waters, and the natural resources within shall be under the powers of the State and shall be used to the greatest benefit of the people."[59] Until 2001, the only decentralized aspect of oil management was that the upper house of parliament, which represents Indonesia's regions, has the exclusive responsibility for legislation related to natural resource management.[60]

In 2001, Swedish officials proposed a wealth-sharing and joint control strategy for Aceh's oil after consultations with GAM leaders living in exile in Sweden. In 2004, a devastating tsunami hit Indonesia's northeast, particularly affecting Aceh. The destruction in the area prompted the GAM to declare a temporary ceasefire, which opened the window for a new round of Finnish-negotiated peace talks. Jakarta and Aceh signed a Memorandum of Understanding in 2005. The resultant law on the government of Aceh provides for joint management of oil and gas resources between the federal government of Indonesia and the Provincial Government of Aceh.[61] For any oil and gas originating in Aceh, the province gets to keep seventy percent of the revenue, as compared to fifteen and thirty percent for oil and gas, respectively, in other Indonesian provinces.[62] The two sides also agreed to a privatized element for revenue allocation, in that an external auditor collects the remaining thirty percent of Acehnese revenue that is due to the central government.

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58 Reid, Anthony. "Indonesia's Post-Revolutionary Aversion to Federalism." In He, Beogang, Brian Galligan, and Takashi Inoguchi, Eds. Federalism in Asia. Northampton: Edward Elgar Publishing, 2007.
59 Haysom & Kane, page 8.
60 See Chapter VIIA 22D, sections 1 and 2 of the Indonesian constitution, as found in Haysom & Kane, page 14.
61 See Article 160, Section 5 of the Indonesian constitution, as found in Haysom & Kane, page 22.
62 See Section 181 of Article 1B of the Law on the Governing of Aceh, as reprinted in Haysom & Kane page 22.

C. CONCLUSION

As these cases demonstrate, divided societies rich in natural resources, particularly oil, are prone to violent conflict. Unfortunately, war is a common outcome in countries where the oil resources are geographically asymmetrical and overlap with ethnic boundaries. Nigeria, Sudan, Indonesia all fought civil wars or experienced protracted insurgencies before reaching a negotiated settlement. Although Biafrans in Nigeria and Acehnese in Indonesia do not face the same export problems as do Southern Sudanese and Kurds, the two groups with export access still depend on the central government for their share of oil revenue. The GAM in Indonesia fought against the state for thirty years and experienced a devastating earthquake before international mediation resulted in an autonomy agreement. The Indonesian government's solution with the secessionist Acehnese is a useful model for the KRG and the Iraqi federal government; after international mediation, the federal government offered to let the Acehnese government keep a much higher percentage of the oil coming from its territory as compared to other Indonesian states. This is preferable to the system in Nigeria, where the parliament did not offer Biafrans a one-time revenue sharing deal. Rather, the parliament must renegotiate oil revenues every five years among numerous competing claims, not restricted to the Biafra region. In Sudan, southerners fought against northerners for over twenty years before they could negotiate peace accords. Although the conflict began over religious differences, finding oil in the 1980s likely exacerbated and prolonged the conflict. Southerners spent an additional six years as an autonomous state before they could vote for their independence. Although South Sudan will soon become independent (as of July 2011), the two sides have much more to negotiate, particularly the exact location of their border.

The only country highlighted in the literature review that reached a negotiated settlement on its oil without military conflict is the UAE; however, there was no secessionist out-group in the Emirates. Rather, those in political power (the al-Nahyan family) are also those with the oil wealth. The UAE also has strong and centralized political leadership; ADNOC's oil management strategy comes directly from the sheikh through the Supreme Petroleum Council. The political situations in the UAE and in democratic, federal Iraq are extremely dissimilar; however, Iraqi politicians should follow Abu Dhabi's example of investing oil revenues in a future fund, which would invest a portion oil revenues in large-scale public infrastructure projects like schools, roads, libraries, and clinics.

Conflict may erupt between Kurds and Arabs in Iraq given the weakness of the Iraqi state as well as the magnitude and multitude of the problems between the two groups. Based on these international cases, war would likely start in Iraq if the federal government in Baghdad either shuts the KRG out from receiving what the KRG perceives as a fair share of Iraq's oil proceeds or prevents the KRG from growing its own oil industry. Iraq is a divided society, with deep tensions not only between Kurds and Arabs, but between Sunnis and Shiites as well; however, the Iraqi case differs from these international comparisons in at least one salient aspect. In the cases outlined above, the group seeking increased autonomy is also the oil-rich region; in Iraq, although Kurds seek increased autonomy, they are not in the known oil-rich part of Iraq. The Kurdish region has some oil, and may have a great deal more, but the extent of its reserves is unknown. The large Iraqi reserves are in the Shiia south, so the pattern would suggest that Shiias would seek increased autonomy. Under the Saddam regime, Shiias and Kurds were both excluded and neglected from state services. While some Shiia politicians have already floated the idea to create a Shiia region in the south (see Section A3 in Chapter 3, below), this idea has yet to gain any real political traction. Whether Shiia Iraqis feel included or neglected in the current system of government will depend on politicians' ability to work in inter-sectarian coalitions and on their ability to allocate resources in a way Shiias perceive as fair.

The case studies show that when a secessionist group feels neglected by the central government and feels they could improve their economic situation with increased autonomy, then conflict can ensue. If Iraq's oil wealth is to be its main driver for economic growth and stability, rather than for division and conflict, elected officials will have to find a way to maintain some central and public control over the country's oil resources. The central government should also allocate at least some of the revenues back to the Iraqi people, specifically to the KRG, so as to suppress secessionist pressures.

Chapter Three: Iraqi oil politics since 2003

Chapter Three begins by identifying key players in Iraqi oil politics and their interests, which is followed by a brief discussion of the constitutional reading that each group is drawing on. The chapter then turns to Baghdad and the KRG's divergent strategies: first, the chapter explains what has happened in Arab Iraq since 2003 in terms of draft legislation and two rounds of oil bidding; second, the chapter turns to events in the KRG's oil sector since 2003, namely the KRG's unilateral petroleum legislation and contract signing. The chapter concludes with information about the limited export agreements between Baghdad and the KRG.

A. Key players

Oil and gas distribution in Iraq overlaps with ethnic and sectarian splits in the country (see Figures 12 and 13 in Appendix C): the Shiia south is particularly well-endowed with oil, and the Kurdish north may be as well. Both groups, excluded from broad political power in Saddam's Iraq, can now enjoy more legal autonomy than under the previous government. The Sunni center-west is not thought to have major oil resources. Accordingly, each major group has a different stance towards the country's future oil management. The dispute between Arbil and Baghdad over oil is just the first major, public post-Saddam debate about the balance of power between Iraq's center and periphery. In the future, groups in the country could divide along many lines on a number of different issues. Therefore, agreeing to an equitable and legal balance of power now will help the country avoid political and violent conflict in the future.

1. Kurds

Approximately 4.5 million Kurds constitute fifteen percent of Iraq's population of thirty million.[63] Kurds welcomed the U.S. liberation, and the area has been largely immune from the sectarian violence that marked Iraq from 2004-2007.[64] Consequently, the KRG is a relatively well-governed part of Iraq where IOCs can operate. The region has also been politically successful, electing approximately twenty-two percent of the current parliament and aligning with the prime minister. Official statements from KRG politicians show that Kurds are positive team players in a newly federal Iraq and moreover, developing their oil industry is in the national interest. Former Prime Minister Nechirvan Barzani, after the first export deal in 2009, stated:

> "We are happy to be part of a federal Iraq within a democratic constitutional framework. When we open these valves today, the Kurdistan region will be earning hundreds of millions of dollars in revenue for all the people of this country."[65]

The KRG has less than 2 billion barrels of oil reserves as of 2010 and is producing at 15,000 barrels/day.[66] The KRG's Minister of Natural Resources, Ashti Hawrami, has played an aggressive role in attracting foreign investment. By drawing maps of oil blocs and keeping access to the ministry open and easy, he has been the face of oil in the KRG. IOCs have signed up to do business with the KRG due to the potentially large reserves and its relative stability. The KRG's first PSA was with the Norwegian company DNO on June 25, 2004 (three days before the CPA's Transitional

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63 Central Intelligence Agency. World Factbook: Iraq. https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html (last accessed May 4, 2011).

64 Salih, Roshan Muhammad. "Iraqi Kurds dance to a different tune." Al Jazeera. April 6, 2004. http://old.krg.org/docs/articles/jazeera-kurdistan-different-apr04.asp (Accessed May 4, 2011).

65 International Crisis Group. "Iraq and the Kurds: Trouble along the Trigger Line. Middle East Report No. 88." July 8, 2009, page 19.

66 Lydecker, R.B. (Bob). Renaissance in Iraq: the Evolution of Petroleum Activities in Iraq from 2004 to 2010. AIPN 2010 Spring Conference. Galveston, Texas, USA. Slide 18. This figure does not include Kirkuk and other disputed territories and was taken before the January 2011 export deal.

Administrative Law took effect). The KRG drafted its own hydrocarbons law in 2007, when it became clear that the parliament would not pass a federal law in a timely manner. Over the last several years, the KRG has signed several dozen contracts for exploration and production, mostly with smaller IOCs that would not be able to afford a major deal in the south and thus do not have to worry about compromising their relations with Baghdad. By signing contracts with the KRG, these companies have been blacklisted by the federal oil ministry.[67] Although the KRG is able to sign its own contracts for exploration and production, it is landlocked and thus cannot unilaterally export oil. The KRG needs approval from Baghdad to use Baghdad's pipeline infrastructure before it can export oil from producing fields. Although there have been several ad hoc agreement for limited exports, these only apply for fields that were producing before 2004. Oil from newer fields is being smuggled out in trucks through Iraq and Turkey,[68] sold for domestic consumption, or is simply not being produced until politicians can reach a comprehensive export agreement.

Kirkuk

Kirkuk is inextricably linked to the KRG's oil politics and overall political strategy. Due to forced migration of Arabs to the Kirkuk governorate and to persecution of Kurds under Saddam, the historically Kurdish Kirkuk area is now a demographic mix of Arabs, Kurds, Turkomens, and Assyrian Christians. Kirkuk is also home to a 15-billion barrel "super-giant" oil field that holds thirteen to sixteen percent of Iraq's oil reserves.[69] The sheer size and importance of the field has been an impediment to political

[67] For a list of IOCs in the KRG, see Figure 14 in Appendix C.
[68] Wing.
[69] O'Leary, Brendan, John McGarry and Khaled Salih. The Future of Kurdistan in Iraq. Philadelphia: University of Pennsylvania Press, 2005. Pages 128-129.

progress between Kurds and Arabs over deciding the boundaries of the KRG. The Kirkuk field was discovered in 1927 and came under the control of the Iraq Petroleum Company in 1934. Current production of one million barrels a day accounts for about one-third of Iraq's total production.[70] The field runs through the capital city of Kirkuk (See Figure 5 in Appendix C), with some homes as little as half a mile away from natural gas flames.[71] Although some of the field is in the KRG, most of it lies in the disputed territories, shown in the hashed area in Figure 5. The transitional administrative law (TAL), in place from 2003-2004, required the government to hold a referendum among the current residents of the governorate to decide whether or not they will join the KRG or remain an individual governorate as part of the greater, federal Iraq; however, the referendum can only take place after the state "takes measures to remedy the injustice caused by the previous regime's practices in altering the demographic character of certain regions."[72] Since the referendum was still outstanding at the time of writing the constitution in 2005, it was carried over into the constitution with a new deadline of December 31, 2007. This date has come and gone without much hope that there will be a referendum soon, despite UN mediation.

In the meantime, the Kirkuk oil field is still producing under Iraqi government control. Oil industry experts agree that the field has been grossly mismanaged and needs significant repairs.[73] A consortium led by Shell began a study on Kirkuk reservoir in

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See also Williams, Timothy. "Allotting of Iraqi Oil Rights May Stoke Hostility." The New York Times. May 29, 2005. http://www.nytimes.com/2009/05/29/world/middleeast/29kirkuk.html (Accessed May 4, 2011).

[70] Williams. See also Global Security. "Kirkuk." http://www.globalsecurity.org/military/world/iraq/kirkuk.htm. (Accessed May 4, 2011). Estimates for Kirkuk's capacity range from 10 to 15 billion barrels.

[71] Williams.

[72] Coalition Provisional Authority. ransitional Administrative Law, Chapter 8, Article 58. http://www.constitution.org/cons/iraq/TAL.html

[73] Global Security.

2005 and later bid on a technical service contract for the field in the first round of bidding in June 2009 (see Section C3, below). The field has not yet been the subject of a successful lease agreement: the Shell and Sinopec consortium wanted $7.89/barrel, whereas Iraq only wanted to pay $2/barrel. The IOCs are still in talks with ministry.[74]

2. Shiias

The Shiia south is extremely rich in oil resources, more so than Kurdish Iraq, yet the country's dominant ethnic group does not have a unified position on oil. The United Iraqi Alliance (made up of the Islamic Supreme Council of Iraq (ISCI) and the Islamic Dawa Party) and its leader and current prime minister Nouri al-Maliki favor centralized control over revenue allocation and welcome IOC investment to help rebuild infrastructure. However, the ISCI has stated its wish for a nine-governorate mega Shiia region to assert more control over its oil wealth. The Shiia mega-region is only a minority opinion and is not currently gaining any real political traction.[75] Opponents to a Shiia mega-region would also like to see an amendment in the constitution that would limit regions to three governorates.[76]

3. Sunnis

Just as the Kurds and Shiias are forces for decentralization of oil management, the Sunnis are a force for centralized control. Sunnis are the ethnic minority in Iraq, but were in political control under Saddam Hussein's Baathist regime. Sunnis live in the center-west of the country, an area without much oil wealth. Since Sunnis will not be producing much of their own oil and will not be net contributors to a federal pool of oil revenues,

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[74] Ryan, Missy. "Iraq Receives one bid for Kirkuk oilfield." Reuters. June 30, 2009. http://www.reuters.com/article/2009/06/30/iraq-oil-kirkuk-idUSLU64947320090630 (Accessed May 4, 2011).
[75] Kane, 8.
[76] Limiting regions to three governorates would also prevent the KRG from adding Kirkuk to its territory.

they prefer that the central government take a stronger role in controlling all of Iraq's natural resources and in allocating its revenues among all groups. In a political ploy to keep central control over oil wealth, Sunnis argue that Iraq's regions, namely the KRG, do not have the required expertise to manage their resources and will be too dependent on foreign companies. They also argue that IOCs will erode Iraqi sovereignty and take money out of Iraqi hands.[77]

4. The Oil Ministry

Arab Iraqis have called the KRG's oil contracts illegal and has been unwavering on this stance throughout the tenure of three oil ministers. Former oil minister Tariq Shafiq complains that the contracts "were never passed to the national parliament and the central Ministry of Oil, nor have they been published to this date."[78] The current oil minister, Abdul Karim al-Luaibi, gave an official reiteration of this sentiment in February 2011, stating that "there is no other party [besides the Iraqi oil marketing company] authorized to sign contract with international companies in this regard."[79] However, the current oil minister, Luaibi, may have a more conciliatory stance towards the KRG: before assuming his current post, he was the Deputy Prime Minister and was in charge of the ministry's negotiations with the KRG.[80] The major thrust of these negotiations was on export deals and on reshaping KRG contracts from their current PSA form to service contracts.[81]

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[77] Beehner.
[78] International Crisis Group 2009, page 17.
[79] Republic of Iraq Ministry of Oil. "The ministry of oil declares for the 4th licensing round." http://www.oil.gov.iq/5551.php (Accessed May 4, 2011).
[80] Iraq Oil Report. "Oil output up, fourth bidding round planned." January 3, 2011. http://www.iraqoilreport.com/oil/production-exports/oil-output-up-fourth-bidding-round-planned-5255/ (Accessed May 4, 2011).
[81] Khaleej Times. "Iraqi Government wants Kurd oil deals amended." February 08, 2011.

5. The United States

After the U.S.-led invasion in 2003, American troops guarded major Iraqi oil fields, confirming many skeptical observers' belief that America invaded Iraq to have access to its oil.[82] Under the CPA, the United States appointed representatives from big oil, two as early as January 2003. [83] The first two oil advisers were Phillip Carroll (a former CEO of Shell Oil) and Gary Vogler of Exxon Mobil. These oil executives served as advisors to the Iraqi Ministry of Oil and played a large role in shaping a package of four draft laws throughout the CPA period that would reshape Iraq's oil sector:[84] the draft hydrocarbons law, a revenue sharing law, and laws to reorganize the Oil Ministry and National Oil Company. Sean Kane of the United States Institute for Peace says that "trying to forge consensus on a hydrocarbon law became the [Bush] administration's primary political initiative in Iraq from 2006 onward."[85] Specifically, the U.S. favored PSAs, in that this type of contract would give IOCs quick access to start investing and to provide the Iraqi state with much-needed revenue. The Iraq Study Group recommended that oil revenue accrue centrally, rather than to the regions, a view ultimately represented in the draft hydrocarbon legislation.[86] Despite the U.S.'s historical pro-Kurdish stance, as evidenced by conducting Operation Provide Comfort and brokering a settlement to the Kurdish civil war, the U.S. has been remarkably silent on the KRG oil issue. This is probably because the U.S. does not want to risk its relationship with Baghdad or interfere

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[82] See, for example, Palast, Greg. "Secret US plans for Iraq's oil." BBC News Newsnight March 17 2005. http://news.bbc.co.uk/2/hi/programmes/newsnight/4354269.stm (Accessed May 4, 2011).
[83] Muttitt, Greg. "Crude Designs: The Rip-Off of Iraq's Oil Weath." Global Policy Forum. November 22, 2005. http://globalpolicy.org/component/content/article/185/40632.html (Accessed May 4, 2011).
[84] There were three pairs of western oil executives: Carroll and Vogler served from January to October 2003, Bob Mckee (ConocoPhillips) and Terry Adams (BP) served from October 2003 to March 2004, and Mike Stinson (ConocoPhillips) and Bob Morgan (BP) served from March 2004 through the end of the CPA in June 2004.
[85] Kane, 5.
[86] Iraq Study Group. "Iraq Study Group Report: A Way Forward – A New Approach." Vintage: New York, 2006. Recommendation 28.

with its oil companies' access to mega-fields in the south by legitimizing the KRG's controversial claims to sovereignty.

B. Constitutional ambiguity

The major development in Iraqi oil politics since 2003 has been the new constitution. Several articles deal specifically with oil and gas, while others deal with the nature of Iraqi federalism. The section below outlines the relevant constitutional articles that create, albeit in vague terms, the legal framework for Iraq's oil management strategy. Appendix B contains the complete text of these articles. The 2005 constitution charges the federal government to pass laws on hydrocarbons management and revenue allocation, but is extremely vague on both accounts. The constitution requires the government to pass comprehensive hydrocarbons legislation, but the parliament has yet to do so.

1. Article 111: oil ownership

First, Article 111 states that "oil and gas are owned by all the people of Iraq in all regions and governorates." However, the KRG and the federal government in Baghdad have interpreted this article in radically different ways, using other sections of the constitution to justify their own reading of Article 111. The KRG interprets this to mean that oil and gas found within the KRG belongs to the KRG, and it has asserted ownership over the oil and gas within its boundaries by unilaterally signing controversial production sharing agreements (PSAs) with IOCs. Iraqi Arabs interpret Article 111 to mean that the Iraqi people as a whole are the sole owner of all of the country's oil and gas. The Iraqi Ministry of Oil has called the KRG's PSAs illegal and unconstitutional.

2. Article 112: a mandate, but no guidance

Article 112 states that the federal government, along "with the producing governorates and regional governments," is to manage oil and gas from present fields, provided that it distributes its revenues "in a fair manner in proportion to the population." The article also does not suggest, much less require, any formula or mechanism for revenue distribution; however, the language does imply cooperative development. Article 112 is also vague about stipulating the type of contract that the federal government (with the producing regional and governorate governments) should use, saying only that it should "develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment." The article is intentionally vague so as to reach a political compromise between all parties; however, it is not a helpful guide for actually allocating revenue among competing groups.

3. The federalist KRG position: Articles 110 & 115

The Iraqi Kurds' reading of the constitution views oil and gas production as a regional matter. Kurds prefer strongly decentralized ownership and want the right to sign their own contracts without needing Baghdad's approval for either existing or new contracts. The KRG believes its actions are fully in line with the constitution, citing articles 110 and 115 to support this view. Article 110 outlines the sole responsibilities for the federal government, and Article 115 states that "all powers not stipulated in the exclusive powers of the federal government [i.e., in Article 110] belong to the authority of the regions." Since oil production is not listed as one of the nine federal responsibilities listed in Article 110, the KRG views its unilateral oil contracts with IOCs as legal. The constitution differentiates between present and future oil fields and validates the KRG's contracts and laws enacted since 1992, when the KRG first formed, "provided they do not contradict with the Constitution."[87] While this last clause is open to interpretation, the KRG uses this article as additional support that its PSAs are legal, especially those that it signed before the transitional administrative law took effect in June 2004, which changed the KRG's status into a federal region of Iraq.

4. The Arab position: Article 121

Both Shiias and Sunnis support strong federal government control over oil ownership and revenue allocation; however, Iraqi Arabs are against passing any hydrocarbons law without concurrent constitutional reform, since the law could be non-binding for the KRG according to Article 121. Article 121 states that regional authorities have the power to override federal law in the event of conflicts with regional legislation. Thus, Iraqi Arabs are justifiably concerned that the KRG could opt out of a national law on hydrocarbons.[88]

C. IRAQI CENTRAL GOVERNMENT (IN)ACTION

The stalled legislative package pertaining to Iraq's hydrocarbons contains four laws drafted during the CPA period and submitted to parliament; however, there has been no legislative progress on passing any of the laws due to parliamentary opposition of many provisions in the hydrocarbons law.[89] In the absence of a legal framework, Iraq has produced and exported oil through a combination of illegal oil smuggling, limited production from pre-existing fields, and ad-hoc technical service contracts resultant from two rounds of international bidding in June and December of 2009.

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[87] Iraqi constitution, Article 141.
[88] Kane, 3.
[89] The first two draft laws are discussed here: the law to manage and develop Iraq's oil and gas and a revenue allocation law. The third and fourth draft laws are to reorganize the Ministry of Oil and INOC.

1. The current system

Even though a post-2003 national legislative framework is not yet in place to govern Iraq's oil production, Iraq is producing and exporting oil from preexisting fields. Iraq's State Oil Marketing Organization (SOMO) sells and exports oil and deposits revenue into an Iraq-controlled account at the Federal Reserve Bank in New York.[90] As of the newest export deal of January 2011 (see Section E below), four percent of the export oil comes from fields in the KRG via federal pipelines.[91] After five percent of the revenue goes to a Kuwait reparation fund, the remainder is transferred to an Iraqi Ministry of Finance account at the Central Bank of Iraq for further distribution to federal government ministries and to the regions and governorates. Absent a federal revenue sharing law, current revenue sharing arrangements are found in Articles 17-20 of Iraq's 2009 Budget Law.[92] The 2009 Budget gives seventeen percent of the federal budget to the KRG, based on population estimates, after deducting for "sovereign expenditures." The law also allows Baghdad to audit the KRG government revenue "to determine any funds that should be transferred to the national treasury" and can withhold transfers if payments are found lacking.[93] Article 20 says the percentage figure can be adjusted after a census "to be held no later than Dec. 31, 2009," a deadline which has now come and gone.[94] In the meantime, oil smuggling continues. Even though American troops paid Sunni tribal leaders to help protect pipelines, these leaders could earn more money by

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[90] Blanchard, page16.
[91] Tawke and Taq Taq have 100,000 bpd ready for export, which is about 4% of the 2.7 million bpd total coming out of Iraq. See Arabian Oil and Gas. "Deal between Iraq Cent. Govt and Kurdistan reached. January 19, 2011. http://www.arabianoilandgas.com/article-8324-deal-between-iraq-cent-govt-and-kurdistan-reached/1/print/ (Accessed May 4, 2011).
[92] Blanchard, page 9.
[93] Ibid., page 16.
[94] Ibid,, page 9.

giving their tribesmen the blind eye when they tapped oil and trucked it across the border to Syria and Jordan.[95]

2. The stalled hydrocarbons draft law

The CPA worked with a three-member Oil and Energy Committee from the Iraqi Cabinet, as well as with foreign oil advisers,[96] to draft a law that would manage and develop Iraq's oil and gas. The Council of Ministers (cabinet) approved the draft on February 26, 2007, although this may have reflected the parliament's desire to placate U.S. domestic concerns rather than real political agreement in Iraq.[97] On July 3, 2007, Prime Minister al-Maliki reported that the cabinet would forward the draft to the Council of Representatives for approval, but public and parliamentary opposition meant that the law has remained a draft since summer 2007. The proposed law advocates a mixture of public and private ownership; while previously-producing fields would stay under INOC control,[98] future fields can be developed by private companies.[99] The logic here is the same that led the KRG to use PSAs; namely, to incentivize an IOC to take on upfront risk. The future fields will require exploration and upfront infrastructure investment. Oil and gas regulation will stay largely under centralized control, with some major concessions towards decentralization. For example, the draft law allows regional governments "to negotiate and initiate contracts for discovered but undeveloped fields on their territory."[100]

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95 Ahmed, Mohammed M.A. America Unravels Iraq: Kurds, Shiites and Sunni Arabs Compete for Supremacy. Costa Mesa: Mazda Publishers, 2010. Page 300.

96 See discussion on page 31 for details about these foreign oil advisors.

97 Kane, page 17.

98 This could only occur after INOC is re-instituted. The law to reconstitute INOC is one of the four draft laws in the hydrocarbons package.

99 Blanchard, page 5 and Muttitt.

100 Bell, Joseph C. "Iraq Hydrocarbons Legal Framework: An Analysis." Iraq Revenue Watch 17 July 2007. http://www.revenuewatch.org/files/RWI_YahiaSaid_HydrocarbonFramework_071707.pdf (Accessed May 4, 2011). Page 3.

While the draft law does not specify one type of contract, such as a PSA, it does say that the "contract holder may be given exclusive right to exploration, development, production, and marketing of Iraqi oil for specified period" which opens the door for private ownership of oil, a sharp contrast from Iraq's past public management of its natural resources.[101] Article 13 lays out a basic model for exploration and production contracts, which may be based upon a service contract, field development and production contract, risk exploration contract, or PSA, as long as they conform to basic criteria listed in Article 9 of the law, and as long as they are approved by the newly-created Federal Oil and Gas Council (FOGC), another contentious aspect of the law.

The FOGC is an unelected body that asserts centralized ownership with its ability to approve all contracts, propose legislation, and adopt policy and regulations.[102] The right to approve contracts extends to preexisting PSAs signed between the KRG and IOCs. Article 9 of the law says that the FOGC would review the KRG's contracts must honor "national control," among other principles. The FOGC would be led by the prime minister and include cabinet members, representatives from regional and producing governorate governments, as well as hydrocarbons experts. The make-up of the FOGC could significantly influence the types of contracts that are approved, and Sunnis are worried they might get excluded from a seat on the FOGC by virtue of their low production levels.[103]

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[101] Blanchard, 26.

[102] Council of Ministers Oil and Energy Committee. "Republic of Iraq Draft Iraq Oil and Gas Law." Iraq Revenue Watch. February 15, 2007. http://www.iraqrevenuewatch.org/documents/oil_law_english_20070306.pdf (accessed May 4, 2011). Article 5.

[103] A producing governorate is one that produces more than 150,000 barrels of crude oil and/or natural gas a day.

Revenue allocation draft law

The second draft law of four is the revenue allocation law, or "law of financial resources." The system proposed is public, with a mixture of centralized and decentralized elements. In contrast to the protracted political support that the U.S. gave to drafting a hydrocarbons law, the revenue allocations part of the package never gained significant attention or traction; in fact, it is only a short five pages, and was drafted in three short months.[104] The draft law empowers the federal government to collect all oil and gas revenues and would create two funds: one for oil revenue and external assistance (such as loans and aid money) and one for internal revenue. Both funds are controlled by Central Bank of Iraq. The KRG opposes total Iraqi control, instead preferring that an international financial institution oversee oil revenue. National priorities, such as defense and foreign affairs are funded first, "provided that this does not impact the balance and needs of the governments of the Regions and the Governorates which are not organized into a region." Another centralizing aspect is the idea of a "Future Fund," mentioned in Article 7, which would take some unspecified amount of revenues for long-term development goals. There are no further details about how much money should go into this account, who should manage it, or the purposes it should be used for. The law states that the details should be defined in separate legislation after more negotiations. In an effort to combat corruption, the law would create a "Commission of Monitoring the Federal Financial Resources" to oversee the funds, conduct audits, and publish transparency reports.

The major decentralizing aspect of the law is that the remainder of the oil revenues, after funding national priorities, is distributed to regions and governorates on a

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[104] Kane, page 3 and Bell "Iraq Hydrocarbons legal framework" page 5. The revenue sharing draft law is available at: http://www.krg.org/pdf/English_Draft_Revenue_Sharing_law.pdf

per-capita basis. Until a census is conducted, Iraq will use “agreed population-density-based percentages.” The KRG quota is currently seventeen percent, which will be deposited into two accounts at the Central Bank branch in Arbil that would provide monthly, automatic payments.[105] Although Article 112 of the constitution deals with the necessity of decentralizing revenue allocation, this draft law “has no provisions addressing Article 112… calling for special allocation assuring compensation to damaged areas and balanced development.”[106]

3. Oil bidding in non-KRG Iraq

Oil production in Arab Iraq is moving at a snail’s pace, given its future capabilities. Current production in Iraq stands at 2.7 million barrels/day, which is already up from the average 2009 production level of 2.4 million barrels/day.[107] Pre-war production levels in 2003 were 2.8 million barrels/day, so Iraq is practically back at its pre-war capacity with plans to dramatically increase production. Two-thirds of this production is from southern oil fields,[108] and more than seventy IOCs have registered with the Ministry of Oil to compete for short-term (two-year) technical service contracts to repair and restore infrastructure. These were abandoned in favor of long-term service contracts in late 2008, in which the Iraqi government pays the IOCs a fee for their services. These technical service contracts were likely the only politically feasible way forward, given the constitutional and legal uncertainty. Yet these contracts also require the Iraqis to take on much of the risk themselves (as opposed to PSAs, in which the IOC takes on the investment risk), which costs the state money and requires expertise it does

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105 Kurdish Regional Government. “Draft Law of Financial Resources.” Article 3, Section 5.
106Bell “Iraq Hydrocarbons legal framework” page 5.
107 Vinson & Elkins LLP. “V&E Energy Industry Series: Iraq Market and Opportunities.” Houston, Texas. April 6, 2011. Slide 11. See also United States Energy Information Administration. “Iraq.” September 2010. http://www.eia.doe.gov/countries/cab.cfm?fips=IZ (Accessed May 4, 2011).
108 U.S. Energy Information Administration.

not have to manage all of its under- or non-producing fields. There have been two rounds of bidding for these contracts, the first in June 2009 for eight fields (six oil and two gas fields, with two in the disputed Kirkuk governorate). The second round in December 2009 covered ten fields. Agreements signed so far account for 60 billion barrels of oil.[109] Absent a federal hydrocarbons law, the government is negotiating each contract on an ad-hoc basis and using pre-2003 laws. While much less advantageous for the oil company, the service contract with Baghdad is a smaller risk than a PSA with the KRG. Major oil companies, such as BP, Exxon, Shell, Gazprom, have won contracts with Baghdad during these bidding rounds. IOCs may be settling for technical service contracts now in the hopes of getting more profitable contracts in the future as Iraq ramps up exploration and production for future fields. This strategy is bearing out; a fourth bidding round scheduled for later in 2011 is rumored to include new fields for exploration, and Iraq will likely have to move towards a PSA model to compensate IOCs for their upfront investments.[110]

D. KRG UNILATERAL ACTION

The KRG wrote its own petroleum law and production sharing contract even though it knew this action would anger the federal government, upon whom the KRG depends for the vast majority of its revenues.[111] The KRG's unilateral signing of oil contracts dates back to 2004; in fact, six of these contracts were in place before the KRG even wrote and ratified its own petrochemicals law and draft PSA.[112] Furthermore, the KRG has started to explore oil and gas resources in the disputed territories (see Figure 6 in Appendix C), an area that the federal government is also allowing IOCs to bid on.

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[109] Vinson & Elkins, slide 12.
[110] Vinson & Elkins, slide 18.
[111] International Crisis Group 2008, page 15.
[112] Ibid., page 17.

1. KRG petroleum law & model PSA contract

The KRG has not waited on the Baghdad government to move forward on developing its approximately forty known oil fields; rather, it interpreted the constitution to mean that Iraq's regions should be responsible for bringing in investment and developing new oil fields on their own. As such, the KRG wrote its own petroleum law and model PSA contract, and published the two pieces of legislation on its website in June 2007. The law gives the region full ownership of its resources in Article 5, which says that "Petroleum in the territory of Kurdistan is owned by the people of Kurdistan, but in a manner consistent with Article 111 of the Constitution;" however, Article 111 clearly states that all oil and gas is owned by all people of Iraq.[113] The KRG interprets Articles 110 and 115 of the constitution as granting regions the exclusive power of taxation; in Article 41 of the draft law, the KRG asserts that "petroleum operations in Kurdistan are liable only to applicable Kurdistan taxes." Even more problematic, the KRG extends the territorial scope of the law not only to the three governorates that form the KRG region, but also to the disputed territories, such as Kirkuk, in Article 3. Yet the KRG is not outwardly adversarial with the federal government in Baghdad about these differences in constitutional interpretation. In fact, the KRG also published an explanatory memorandum on its website to accompany the Petroleum Act and the PSA, which asserts the "the draft Iraq Act is consistent with the attached draft Act for Kurdistan… the Iraq Act, if adopted, [will] ensure the development of a coherent national Iraqi petroleum sector."[114]

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[113] Kurdistan Regional Government. "Proposed Petroleum Act for the Kurdistan Region of Iraq." August 7, 2006. http://www.krg.org/pdf/Kurdistan_Petroleum_Act_Final_Draft.pdf (accessed May 4, 2011).
[114] Kurdistan Regional Government. "Explanatory Memorandum for the Proposed Petroleum Act for the Kurdistan Region of Iraq and a Proposed Model Production Sharing Agreement." 7 August 2006. ttp://www.krg.org/pdf/Explanatory_Memorandum_Kurdistan.pdf (accessed May 4, 2011).

In keeping with this conciliatory attitude toward the federal government, the KRG shares revenue from current and future oil and gas produced in the region with the federal government, even though the constitution does not stipulate that it must.[115] The KRG interprets Article 111, that oil and gas belong to all Iraqis, and the vague Article 112 (that suggests Iraq come up with a way to share revenues) to mean that it owes Baghdad a portion of the oil it produces. The KRG law also goes further than what is set out as a baseline in the Baghdad draft law by requiring IOCS to include local partners and by requiring technology transfer and training for those local partners.[116]

Article 39 of the KRG Petroleum Act frames the basic terms of any contract between the KRG and an IOC as a production sharing agreement (PSA). The model PSA contract, published at the same time as the petroleum law, goes into further detail. In an effort to usher in foreign investment as quickly as possible, the KRG has given up control of its resources by privatizing ownership.[117] The KRG's PSA contract is long-term: under Article 6 "Term of the Contract," the exploration period can last up to 14 years and the development period up to 25 years. The KRG makes two other major concessions to private actors in its model PSA: The KRG gives up its ability to determine how quickly its oil is produced (or rather, depleted) in Article 16.2; in the event that the maximum extraction rate is decreased, that the KRG is obligated to extend the contract so that the IOC can still remove its desired amount of resources. Finally, the KRG allows international law to take precedence over KRG law in the event of disputes. Article 41 says that any dispute has to be settled in international courts and the "rules of the London Court of International Arbitration shall apply." However, the KRG may have stipulated

[115] Blanchard, page 6.
[116] Kurdistan Regional Government. Proposed Petroleum Act, Articles 46-48.
[117] Muttitt.

these conditions out of necessity since the KRG wanted to attract IOCs quickly and since it lacked a basic petroleum infrastructure.

2. IOCs in the KRG

Investing in the KRG as an IOC is a risky proposition. Since Saddam generally overlooked the Kurdish north for production capabilities, there is no preexisting infrastructure in place and no clear estimate of how much oil the region might possess. Despite the geological, economic, legal, and political risks inherent in doing business with the KRG, approximately forty companies have signed up to do so. The companies are generally smaller, more risk-prone, and could not afford to buy a major contract in southern Iraq. The exploration blocks in the KRG were offered at prices far below what it would cost to win an oil bid for one of the big fields in the south. Additionally, the relative security and favorable PSA contracts that the KRG offered made it attractive for small international firms to invest. When the fields were opening up in 2004, Iraqi Kurdistan was one of the final frontiers open for exploration. A map of exploration blocs in the KRG (see Figure 14 in Appendix C) lists small, international companies such as Hunt Oil (Dallas, TX), Genel Energie and Petoil (Turkey), DNO (Norway), Oil Search (Papua New Guinea), KNOC (South Korea), Reliance (India), Heritage and Western Zagros (Canada), and Gulf Keystone (United Kingdom). Major oil companies are also investing in Kurdish Iraq, such as China's Sinopec and Marathon Energy (Houston, TX).

It is unclear why oil companies are spending money upfront on investments in the KRG with no current and comprehensive legal way to export the oil.[118] For example, Genel Enerji paid $500 million in capital costs for access to the Taq Taq field.[119] To

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[118] Only DNO and Genel currently enjoy the right to export. See Section E below for details

[119] Foreign Reports Bulletin. "Kurdish Exports and Oil Politics." June 1, 2009. http://www.foreignreports.com/images/Kurdish_Exports_and_Oil_Politics.pdf (Accessed May 4, 2011).

further complicate matters, if a company signs up to do oil business with the KRG, the federal oil ministry will blacklist that company, which means that by signing PSAs with Arbil now, IOCs are forfeiting their chance to do business with Baghdad later.[120] Most likely, these companies are just eager to get a foot in the Iraqi oil market in any way possible. IOCs understand that Iraq will have many long-term opportunities and can safely assume that their contracts will not be annulled.[121] At best, the KRG and the federal oil ministry will come to an arrangement that would allow all IOCs to invest in any part of Iraq. Additionally, the proposition of investing in a politically risky climate with no clear export route seems more palatable given that the KRG is offering attractive terms.

In the almost seven years of the KRG oil industry, there have been successes and disappointments. Several companies are making significant discoveries, such as Gulf Keystone, while others have been disappointed to find natural gas instead of oil. For example, Dana Gas out of the UAE has redeveloped fields in Chemchemal to provide gas to power plants in the KRG. Many IOCs have had their contracts renegotiated multiple times, ostensibly to bring the KRG's PSAs in line with what Baghdad would approve, although the more likely explanation is that the KRG realized it could get a better deal. Even with these renegotiations, no IOCs have yet brought a case to the London Court of International Arbitration. There are also allocations that the government is corrupt, not only among IOCs but also among Iraqi Kurds themselves, hundreds whom have gathered

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[120] United Press International. "Iraq makes good on Kurd oil blacklist." Jan 21, 2008. http://www.upi.com/Science_News/Resource-Wars/2008/01/21/Iraq-makes-good-on-Kurd-oil-blacklist/UPI-92691200950192/ (Accessed May 4, 2011).

[121] The KRG contracts would likely only be annulled in an extreme conflict (political or violent) between the KRG and Baghdad. See Chapter 4, Section B for more information.

to demonstrate in Sulaimaniya in late March 2011 against their government's corruption and lack of service provision.[122]

E. LIMITED KRG-BAGHDAD PROGRESS

The federal government controls all of Iraq's pipelines, so the KRG needs express permission from Baghdad, by way of an Iraqi certificate of origin, before any of its oil can flow through Iraq's pipeline network through Turkey and out to the Mediterranean Sea via Ceyhan (see Figure 15 in Appendix C). For IOCs that have been operating in the KRG for some time now, namely DNO (running the Tawke field) and Genel (running the Taq Taq field), this means that profiting from any produced oil is difficult. While there is no shared pipeline use agreement between the KRG and the federal government, there have been two ad-hoc export agreements to allow limited exports from the KRG's Tawke and Taq Taq fields, both of which were already in production before 2004. In November of 2008, the federal government allowed the KRG to link these two fields to the Ceyhan pipeline. The North Oil Company, a branch of the federal Ministry of Oil, worked on implementing the agreement through building connector pipelines, and exports began in June 2009. The KRG does not get to keep the sales revenues; rather, all money from the KRG oil exports is deposited into an independent offshore escrow account. The money is then divided according to the revenue allocation system already in place, meaning that the KRG gets seventeen percent of the revenue earned.[123]

To complicate matters further, the government in Baghdad did not recognize the legality of the contracts with DNO and Genel. The KRG must then pay the companies for their contracted cost oil out of the allocated seventeen percent.[124] The KRG is arguing

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[122] Salih, Mohammad A. "Iraqi Kurdistan's Liberation Square." Al Jazeera. March 8, 2011. http://english.aljazeera.net/indepth/features/2011/03/201137131012153528.html (Accessed May 4, 2011).
[123] International Crisis Group 2009, pages 17-19.
[124] Ibid., page 17.

that if the federal government views the oil as Iraqi oil (rather than Kurdish oil), that the federal government should repay the cost oil to the IOCs. While the two sides argue, the two IOCs in question are not recovering their upfront investments, and the other companies have no way to export legally. Exports have stopped since the KRG and Baghdad could not find a way to pay the companies.

A second export deal for Taq-Taq and Tawke was signed in January 2011 after talks in 2010 regarding how to pay the IOCs. The talks resulted in Baghdad agreeing to pay the IOCs back for their cost oil, but leaving the KRG to pay companies their share of profit oil out of the KRG's seventeen percent of the federal budget. While this newest deal may result in IOCs getting their investment money back, it is still unclear how any of them will get a steady revenue stream from the profit oil. Given this climate, the optimistic plans to increase KRG oil exports to 250,000 barrels/day by the end of 2011 seem overly optimistic. The agreement also does not allow the KRG to have full control over oil production; rather, they are still dependent on Baghdad, forcing negotiations for each company's ability to export. Fields operated by Gulf Keystone and Heritage are primed to export in the near future, so the need for a comprehensive pipeline use agreement will continue to increase.[125]

Alternatives to exporting via the Ceyhan pipeline are either sell oil for domestic consumption or smuggle the oil out. If the IOCs have exhausted their legal export quota or if no deal is in place (as was the case between 2004 and 2008), they can sell oil on the Iraqi market. Before the latest export deal in January 2011, DNO and Genel were selling oil for domestic consumption for less than half of world price, which brought their

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[125] Petroleum Economist. "Kurds upbeat over new Iraq oil export deal." January 20, 2011. http://www.petroleum-economist.com/Article/2801378/Kurds-upbeat-over-new-Iraq-oil-export-deal.html (Accessed May 4, 2011).

production levels down to extremely low levels.[126] The second alternative to legal exporting is illegal smuggling: the KRG's neighbors with sea access, namely Turkey and Iran, will not openly support exporting KRG oil without the Iraqi certificate, but Iran, and probably other neighboring states as well, are allowing oil trucks to pass through.[127] Since smuggling the oil is at least marginally profitable since Oil for Food Program days, those benefitting in the KRG have less incentive to work on an official and legal pipeline export agreement. Although oil smuggling is certainly a stop-gap measure to tide the KRG oil industry over until a negotiated settlement, exact numbers about how much oil is being smuggled, by whom, and to where are hard to come by due to the illicit and underground nature of smuggling. As a legal and profitable alternative, the Internatinoal Crisis Group (ICG) suggests that the KRG strike a deal with Turkey by committing to restrict PKK movement inside its borders in exchange for access to Turkey's pipelines.[128]

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[126] Pipeline Community. "DNO restarts Kurdistan Ops despite Export Impasse." October 11, 2009. http://www.pipelinecommunity.com/Oil-News/dno-restarts-kurdistan-ops-despite-export-impasse.html (Accessed May 4, 2011).

[127] Dagher, Sam. "Smugglers in Iraq Blunt Sanctions Against Iran." The New York Times. July 8, 2010. http://www.nytimes.com/2010/07/09/world/middleeast/09kurds.html (Accessed May 4, 2011).

[128] International Crisis Group 2008, page 31.

Chapter Four: Analysis

A. Summary & review

A number of factors are working in tandem to keep Iraq from managing its oil and gas resources effectively. Given the multitude and magnitude of these problems, Iraq's future production of hydrocarbons is uncertain. Drawing on the international comparisons outlined in the literature review, this chapter analyzes the likelihood that there could be a descent into conflict or war (a lose-lose for both sides, as in Sudan), a negotiated settlement (a win-win for both sides, such as in Indonesia or in the UAE), or a stalemate. Owing to the constraints and outstanding issues in Iraq, the current path, i.e., a political and legal stalemate is most likely. The chapter concludes with a brief consideration of the ramifications of a stalemate.

1. Kurdish aspirations for autonomy

The Kurd's unilateral action in developing their own oil industry is certainly an impediment for the federal government in Iraq developing a national hydrocarbons management system. When the TAL expired in summer 2004, the three Kurdish governorates became a constitutionally-protected region. Days before this changed occurred, the KRG acted quickly to sign its first PSA with Norway's DNO, not waiting on parliamentarians in Baghdad to agree on a national oil management strategy that might have limited the KRG's autonomy. Getting international, especially American, companies to sign exploration and production contracts in the KRG gives the region's nascent oil industry a veneer of legitimacy. Many IOCs may have also signed the contracts for political support rather than for grand hopes of economic success. IOCs knew the political, economic, security, and geologic risks at the time of signing. The KRG acted so quickly because obtaining ownership of its own oil resources was more important than securing the "secondary economic benefits of a full-fledged oil industry" like refineries or pipelines.[129] That the KRG already has a contracting system in place and has already sold many of its blocs to IOCs leverages its bargaining position in relation to Baghdad; the KRG is essentially making a bet that Baghdad will have to accept its nascent industry and PSAs as a *fait accompli*. However, this bet may backfire since Baghdad controls the transport system.

Another major stumbling block for Kurds and Arabs vis-à-vis Kurdish autonomy is the Kirkuk problem.[130] Due to the demographic changes in the area, conducting a census, holding a referendum on Kirkuk, and deciding the boundaries of the KRG have become a set of interrelated issues. According to Article 140 of the constitution, referendum on Kirkuk or in any disputed territory cannot take place until the Iraqi government conducts a census, as the state needs to know who lives in the governorate before allowing them to vote on their status. Yet holding a census is so problematic that there has not been one since 1987.[131] Lacking accurate census data, the country bases its population estimates off of the food rations distribution system set up after the Gulf War in 1991. Any family that wanted food had to register with the local distribution centers and was entitled to rations based on number and age of people in their household. A formal nation-wide census was supposed to take place under the TAL period, but both Kurds and Arabs are fearful of the demographic realities that a new census could reveal and therefore neither side is pushing for progress on this front; however, until there is an accurate count of who lives in Iraq, where they live, and with which ethnic and religious

[129] International Crisis Group, 2008, page 23.
[130] See Chapter 3, Section A1 for a more complete discussion.
[131] BBC News. "Iraq abandons nation-wide census." August 17, 2009. http://news.bbc.co.uk/2/hi/8204550.stm (Accessed May 4, 2011).

groups they identify, it will be difficult, if not impossible, to allocate revenue from oil sales equitably.

2. Problems with the draft federal hydrocarbons law

In the four years since the publication of the draft law in 2007, Iraq's national assembly has made no progress towards passing a law. In its current form, the law would grant regional authority for managing oil resources and provides for PSAs, which is the path that the KRG has already taken with its oil. As such, the KRG is in favor of passing the law as is, but Arab parliamentarians have reservations. The long-term nature of PSAs is that the contracts outlast future elected governments which were not part of original negotiations. Subsequent governments are not allowed to change the terms of the terms of the contract according to the stabilization clause,[132] which immunizes IOCs from future laws, regulation, and government policies. While this is normal for most oil contracts, it may become problematic if the KRG and the federal government have to renegotiate these contracts as part of a federal legislative solution.

In addition to figuring out how to pass a law that both the KRG and the remainder of Iraq can agree on, Iraqis are concerned about giving foreign IOCs too much access to their oil resources. This strong feeling of nationalism and anti-western imperialism is driving much of the parliamentary opposition, as are Sunni concerns against drastic changes to the status quo. The draft law is favorable to western IOCs, in part because ex-oil executives from the USA helped draft the law. One particularly pro-western result of their advising was the Federal Oil and Gas Council's (FOGC) "Panel of Independent Advisors," which can include an unlimited number of Iraqis or foreigners. This has many

[132] Kurdistan Regional Government. "Explanatory Memorandum for the Proposed Petroleum Act for the Kurdistan Region of Iraq and a Proposed Model Production Sharing Agreement." Article 31, Section 9.

observers worried about the potential leverage that IOCs could have over the executive branch of the Iraqi government to advance their own interests.

3. Constitutional ambiguity

Constitutional ambiguity has led to two viable but contradictory interpretations of Iraqi federalism: the KRG argues that the constitution gives regions the right to (or at least does not expressly forbid them from) developing their own legislative framework for oil production. Iraqi politicians in Baghdad, however, have come to the opposite conclusion and say that the constitution does forbid this action. Whether or not the KRG acted in accordance with the constitution may become a moot point since any oil produced from KRG fields would have to enter into the Iraqi or international pipeline network for export. Kurdish oil will most likely be subject to federal control after all, as evidenced by the two recent export deals concerning the Tawke and Taq-Taq oilfields (see discussion in Chapter 3, Section E).

Revenue allocation is another vague area of the constitution; since there is no clear guidance or automatic revenue sharing formula in place, politicians decide how to allocate oil proceeds to regions and governorates as part of the annual budget negotiations cycle, which are subject to change depending on who is elected to the national assembly. This makes already tepid partners in newly federated Iraq uneasy. Although based on population estimates, the KRG's seventeen percent allotment could be reduced in the future if the political make-up of the parliament changes, if the KRG's unilateral actions continue to be unpopular in Baghdad, or if a new census reveals sizeable population shifts.

B. WHITHER IRAQ?

Iraq's oil and gas industry is at a crossroads; since the draft law was introduced in 2007, and progress has been ad-hoc and incremental rather than comprehensive. Going forward, Kurds and Arabs could go one of three ways regarding their oil management: first, the disagreements could intensify into conflict or civil war; second, the KRG and the federal government could reach a negotiated settlement; or third, the two sides could stay at a standstill. The international examples from the literature review in Chapter Two show that conflict is a likely outcome when oil resources are split among groups within a state in a manner that one group perceives as unfair. Eventually, however, these conflicts do end with a negotiated settlement. In the case of Iraq, the current standstill will likely persist despite recent sectarian war.

1. Conflict or settlement?

Due to the size and scope of Kurdish grievances with other Iraqis, several authors, such as James Fearon and Peter Galbraith, predict that Iraq's political conflicts have the potential to turn violent.[133] Whether the country can solve its outstanding problems peacefully depends in large part on how long the Sunnis stay politically dominant. If the strong centralizing Sunni force erodes quickly, decentralizing forces, like the KRG, may gain a stronger foothold. This would further destabilize the newly federal Iraq. While many Kurdish leaders know that they will be part of a federal Iraq for the foreseeable future, many of them eventually want an independent Kurdish state or at least increased autonomy. If Baghdad ceases to make accommodations and the protective American troops are gone, there may be open military hostilities. Kurds are very proud of the

[133] Fearon, James D. "Iraq's Civil War." Foreign Affairs. March/April 2007. See also Peter W. Galbraith "What Went Wrong" In: O'Leary, Brendan, John McGarry and Khaled Salih. The Future of Kurdistan in Iraq. Philadelphia: University of Pennsylvania Press, 2005. Pages 235-267.

autonomy they have already won and would likely fight to protect it. In fact, the KRG has its own military, the *pesh merga* (lit: those who face death), with approximately 200,000 soldiers.[134] The *pesh merga* already has forces in place to take over oil field security from IOCs, which shows the strategic importance the KRG places on protecting its oil industry.

Although the Iraqi infighting since 2003 has not been between Kurds and Arabs, the inter-sectarian violence shows how fragile and tenuous the bonds are between different Iraqi groups. There is also the potential for in-fighting between the two major Kurdish groups within the KRG – the PUK in the south and the PDK in the north. The two sides fought a civil war in the 1990s, but seem to have unified their position since 2003 in order to consolidate gains for the KRG as a whole. In fact, they bridged the historical PUK-PDK divide by putting forward a unified list of candidates for 2005 elections to the national assembly in Baghdad. The Kurdish Alliance won fifteen percent of the national vote. However, the traditional two-party dominance does have fierce critics. The new Gorran (Change) party formed in 2010 and its candidates ran on a platform of anti-establishmentarianism that reflects common frustration with the old Talabani-Barzani divide.[135] The message was popular: Gorran won half a million votes in the 2010 parliamentary elections, garnering four percent of seats in the national parliament.

While violent conflict may not be where Iraq is headed in the immediate future, there is a slim likelihood that the KRG and the federal government will soon reach a

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[134]The KRG announced in Jan. 2011 that it will downsize the size of its armed forces to 70,000. Kurd Net. "Iraqi Kurdistan Armed Forces, Peshmerga, to Lose 130,000 Soldiers. January 17, 2011. http://www.ekurd.net/mismas/articles/misc2011/1/state4537.htm (Accessed May 4, 2011).

[135]Dagher, Sam. "Block takes on entrenched Kurdish parties in Iraq." The New York Times. March 6, 2010. http://www.nytimes.com/2010/03/07/world/middleeast/07kurds.html?_r=1 (Accessed May 4, 2011).

negotiated settlement. A settlement will be difficult due to the complexity of the obstacles, such as delineating the boundary of the KRG, which means that one or both sides will have to make major and uncomfortable compromises, such as giving up territory or access to oil. The most likely path towards a negotiated settlement is an economic one; namely, that once the federal coffers in Baghdad get money coming in from the limited KRG exports, politicians will continue to foster such exports. However, even if the federal government in Baghdad recognized the legality of the KRG contracts, allowed KRG oil to be exported through Iraqi pipelines, and even to let the KRG keep a high percentage of the proceeds, the KRG would still be unsatisfied until they reached a deal on Kirkuk. The territorial dispute makes the likelihood of a negotiated settlement much smaller (see Figure 12 in Appendix C for a map of the disputed territories).[136]

2. Ramifications of a standstill

Given these difficulties, the status-quo is likely to prevail over the near-term future. The KRG is keenly aware of this and is using this post-2003 political and legal gray zone to its advantage. First, the KRG is signing as many contracts as early as possible with IOCs, especially Turkish and Iranian companies to establish its industry and to entrench IOCs. If Baghdad threatens to nullify or take over the KRGs contracts, it will first have to contend with international partners wanting to protect their business interests. Second, the KRG aims to strengthen its economic position vis-à-vis Baghdad by developing its international economic ties beyond the oil industry. The Arbil International Airport is now linked to many other western countries, and there are new hotels, restaurants, gated residential communities, banks, and universities. The KRG is also

[136] See discussion of options on Kirkuk in Chapter 5, Section B below.

developing its tourism industry, and the New York Times included Iraqi Kurdistan as one of its “41 places to visit in 2011.”[137]

Despite the advantages of a standstill for the KRG, there are also many negative ramifications. If Baghdad does not allow for all of the KRG’s produced oil to flow through its pipelines, a standstill could lead to additional illicit smuggling or an inability for IOCs to continue producing oil. A political standstill that allows the KRG to continue developing unilaterally could also lead towards increased sectarian tensions between the KRG and Baghdad. If Arab politicians in Baghdad feel that the KRG’s development is illegal or that that KRG is earning enough money on its own, they could reduce the KRG’s share of federal budget allocations or shut them out completely. These tensions could also lead to violent conflict as was the case in Nigeria, Sudan, and Indonesia. While a continuation of the status quo is the most likely short-term outcome in Iraq, it is also dangerous and instable.

[137] The New York Times. “The 41 Places to Go in 2011.” January 7, 2011. http://www.nytimes.com/2011/01/09/travel/09where-to-go.html (Accessed May 4, 2011).

Chapter Five: Policy recommendations

Iraq still faces many obstacles to having an effective oil and gas industry to which all groups agree. Some of these obstacles are larger and more obvious, such as the need to pass comprehensive hydrocarbons legislation or reform the constitution, but are nevertheless crucial for long-term progress and development. After briefly mentioning these major legal and political stumbling blocks, the chapter then focuses on incremental reforms that are more realistic for the government to approach in the short-term, such as increasing transparency in its hydrocarbons industry, several scenarios to resolve the Kirkuk issue, and training Iraqis to work in the oil industry.

A. Legal fixes

The most obvious and yet most crucial recommendation to improving Iraq's hydrocarbons industry is to pass the set of four draft hydrocarbons laws. The new government formed in late 2010 stated that passing these laws is a priority, and is pursuing an incremental rather than package-deal approach.[138] Parliament should pass a permanent revenue allocation strategy, or at least one that cannot be changed for at least ten years, so that the issue does not have to be constantly revisited. Indeed, Iraq's 2011 budget (not yet published) depend on KRG export revenue.[139] For the aspects of the laws that prove to be beyond incremental reform, Iraqis may require international expertise or mediators to usher along reform.

One of the four outstanding laws is to re-constitute the Iraqi National Oil Company, since legislation for the previous company was repealed in 2003. As discussed

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[138]Lando, Ben. "Q&A: Adnan Jalabi." Iraq Oil Report. April 12, 2011. http://www.iraqoilreport.com/politics/oil-policy/qa-adnan-janabi-5591/?utm_source=rss (Accessed May 4, 2011).

[139] Iraq Business News. "Oil Exports from Kurdistan Delayed." February 1, 2011. http://www.iraq-businessnews.com/2011/02/01/oil-exports-from-kurdistan-delayed/ (Accessed May 4, 2011).

in Chapter 2, Section 1, unbundling the NOC and pursing partial and incremental privatization could bring much-needed expertise. Breaking the NOC down into regional components, such as the North Oil Company and South Oil Company (see Figure 16 in Appendix C), will also have politically positive decentralizing effects.[140] Algeria encouraged joint ventures in services such as geological analysis and drilling, which, if applied to Iraq, could help create new Iraqi businesses and may also encourage technology transfer.[141]

The KRG and federal government's interpretations of the country's constitution are so at odds that any new legislation will need to be accompanied by constitutional reform (see discussion in Chapter 3, Section B). A constitutional review committee submitted a report to parliament on May 23, 2007 with several suggestions to change the constitution and unify it with the hydrocarbons law. The committee suggested an automatic distribution of revenues and that the federal government take authority in oil and gas-related disputes with regional governments (Article 121). These constitutional fixes would clarify the KRG's (as well as any future regions') status and obligations vis-à-vis the federal government. The committee's suggestions have not yet been adopted.

B. POLITICAL FIXES

Beyond legal changes to the constitution and to hydrocarbons legislation, both the KRG as well as politicians from the federal government in Baghdad need to make a number of hard political compromises to move the country's oil industry forward. Many of these changes can be made without any changes to the law and could have profound effects. For example, Baghdad could recognize the legality of the KRG contracts with a statement out of the Ministry of Oil. The KRG does have the right to develop an oil

140 Springborg, page 83.
141 Ibid., page 94.

industry as a constitutionally-protected region; however, export oil may fall under federal control over "regulating commercial policy across regional and governorate boundaries" as outlined in Article 110. To get federal government approval for its contracts, the KRG should alter them meet Baghdad's standards. This would allow the KRG to maintain its regional oil industry and to legally export any oil found in the KRG. One way to placate both sides would be to bring the KRG's industry under federal control in return for letting the KRG keep a higher percentage of the oil it pumps from its territory, similar to Acehnese arrangement in Indonesia. The rationale for this higher percentage in Indonesia is that the area bearing the burdens of production receives compensatory payments for years of discrimination by the central government and to bring an end to the GAM guerilla movement. In Iraq, the KRG has a claim to keep a higher percentage of the oil revenue originating from its fields since it is bearing the costs of production and since the constitution allows for groups that were "unjustly deprived" under the Saddam regime to be compensated with oil revenue.[142] The KRG could then pay the federal government transfer fees to access the federal pipeline system instead of splitting revenues by population percentage estimates. Export arrangement may change once the Nabucco pipeline, which will run through the KRG into Turkey, is operational in 2015.

1. Transparency

Regardless of how Iraq decides to allocate ownership rights and oil revenues, a large portion of Iraq's oil money will stay centralized and under state control. This is the typical MENA model, and Iraq operated this way prior to 2003. There should be transparency measures in place for the money that stays under INOC control to ensure that the money is spent and invested properly and to minimize corruption. One popular

[142] See Article 112 in Appendix B.

idea to promote transparency in global oil markets is to require both IOCs as well as governments to publish how much they pay and receive for contracts and exports.[143] Iraq's bidding rounds have been very open and transparent, and the Oil Ministry should build on this progress. By signing on to the "publish what you pay" (PWYP) campaign, started in 2002 by the Open Society Institute and Global Witness, Iraq could make a public statement about its commitment to proper use of its oil revenues. Over fifty countries have signed on to the PWYP campaign, and the members are a mix of small and developing (Azerbaijan and Chad) as well as highly-industrialized (Norway and the United States).[144] However, no Arab countries are signatory to the campaign, with the exception of Mauritania. Another similar idea is the Extractive Industry Transparency Initiative (EITI) put forward by the UK's Department for International Development (DFID) in 2002. Countries who are interested first sign on as candidate countries and then go through a two-year validation period before they are deemed compliant. Nigeria is compliant country, and Jill Shankleman asserts that its membership in the EITI has helped to build collaboration between government, international donors, and civil society organizations.[145] Iraq is currently a candidate country whose validation period will end in February 2012, but its application to EITI demonstrates its willingness to be public about its oil earnings.[146] However, the EITI application does not include the KRG, which points to a lack of transparency in the KRG's contracts.[147] Both the federal and KRG oil ministries should adhere to these transparency standards.

[143] Karl, page 274.
[144]Publish What You Pay. "Where we work." http://www.publishwhatyoupay.org/en/where (Accessed May 4, 2011).
[145] Shankelman, page 6.
[146]Extractive Industries Transparency Initiative. "Iraq." http://eiti.org/Iraq (Accessed May 4, 2011).
[147] The EITI website lists the following state-owned companies as participants: North Oil Company, South Oil Company, Maysan Oil Company, Midland Oil Company, and the Iraqi Oil Exploration Company. This

Joseph Bell, writing about Sao Tome and Principe's oil industry, has several observations about transparency initiatives that the country implemented locally without signing on to international campaigns. The state publishes information about how oil revenues are used in the national budget via newspapers, radio, or town hall meetings.[148] Sao Tome and Principe also established an oversight commission tasked with ensuring that investments from oil revenues be secure and non-speculative. In addition, the commission also manages regular auditing and reporting.[149] The country instituted legal sanctions against bribery and abuse of office, as well as established a public information office for citizens to access data about the oil industry. A combination of these international campaigns and local measures would be especially effective in Iraq, since oil revenues account for the vast majority of the government's revenue. Preventing corruption will be especially challenging in Iraq, given the weak nature of many of the state's institutions. To counter the possible tendency towards corruption, mismanagement of resources, and embezzlement, the Iraqi state should adopt as many of these transparency initiatives as possible.

A more indirect way to facilitate transparency is distribute some of the oil revenue directly to the Iraqi people. As mentioned in Chapter Two, Section A, Birdsall and Subramanian advocate that at least fifty percent of the oil revenues be distributed to the people and that the other half stay under state control.[150] Giving money to the people is not only in line with the constitution, which states that "oil belongs to all the people of Iraq," but it would also solve other issues, such as "horizontal inequality," the census and

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does not include the KRG. See Figure 16 in Appendix C for a map of these companies' areas of responsibility. See also International Crisis Group 2009, page 16.

[148] Bell, in Humphreys et al. page 277.

[149] Ibid., pages 299 and 303.

[150] Birdsall and Subramanian.

increasing investment. "Horizontal inequality" is what Michael Ross calls the gap between resource-rich and poor regions.[151] By decentralizing revenue allocation, states can reduce horizontal inequality and diffuse sectarian tension. Distributing money directly to the Iraqi people would also require the state to conduct a census so that it could distribute money accurately. If citizens understand they will receive money as a result of being counted, they are more likely to come forward and participate in an effective census. Having an accurate census to work from would also facilitate a decision on Kirkuk (see below). In order to receive the oil revenue transfers, many Iraqis would need to open a bank account, and the increased savings would allow banks to invest and offer loans to emerging businesses. Furthermore, since the federal government's decisions on how to manage oil wealth would directly affect citizens' bank accounts, Iraqis may increase their demands for democratic accountability.

2. Kirkuk

The second major stumbling block in Iraqi oil politics, behind passing the hydrocarbons laws, is on the status of the Kirkuk governorate and of its super-giant oil field. The KRG claims Kirkuk as part of its historical territory. Baghdad says that the area is no longer majority Kurdish, and the original inhabitants, the minority Turkmen population, are drowned out between the two sides. The constitution calls for a referendum among the residents of the entire governorate to determine whether it will join the KRG or remain part of federal Iraq.[152] The most straight-forward way to solve the issue is to conduct the popular referendum and abide by the will of the inhabitants. Yet politicians have not wanted to conduct the referendum because neither Kurdish nor

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151 Ross, Michael L. "How Mineral-Rich States Can Reduce Inequality." In: Humphreys, Macartan, Jeffrey D. Sachs, and Joseph E. Stiglitz. Escaping the Resource Curse. Columbia University Press: New York, 2007. Page 246.

152 See Article 140 of the Iraqi constitution (listed in Appendix B) and also Articles 57 & 58 of the TAL.

Arab politicians are willing to permanently lose its claim over the oil field, estimated to hold 15 billion barrels.[153]

Since holding a referendum has proven politically infeasible so far, the International Crisis Group (ICG) suggests holding a grand bargain, which they call the "oil for soil" strategy. The Kirkuk oil field would stay under Baghdad control in exchange for the governorate's territory and other natural resources going under KRG control. The KRG would still get its seventeen percent allocation of Iraqi oil revenues, which would include proceeds from the Kirkuk field. Alternatively, the KRG could waive its claim over Kirkuk in order to manage and export its own oil and gas. The KRG may not want to take this deal depending on future revenues it receives from Baghdad. The KRG will likely be a net receiver in any national revenue sharing scheme since it has so much less oil than Iraq's south. Another way that the ICG suggests to solve the Kirkuk issue without a referendum is to create a one-governorate region for an interim period of at least ten years.[154] In creating the new Kirkuk region, drafters should be sure to implement power-sharing at all levels of government that reflects the region's demography.[155]

C. IRAQI OIL FOR IRAQ'S FUTURE

The KRG and the federal government in Baghdad will earn billions of dollars from its oil and gas resources over the coming years. In order for Iraq to create a stable economy, the Iraqi population must be the primary beneficiary of the nation's oil wealth. Citizens should benefit not only in terms of receiving a check every month or every quarter as in Alaska, but also in terms of developing an educated workforce that can

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153 Williams.
154 International Crisis Group 2008, page 30.
155 Ibid. The ICG suggests a split of 23-23-46-8 for Arabs, Turkomens, Kurds, and Christians, respectively.

actively and profitably participate in the oil industry. One way to start this process is by including a local hire provisions and technology transfers into every contract. The KRG's model PSA already includes a local hire provision which states that a certain percentage of employees must be local hires. Other countries could prove a useful model for Iraq here, too: Nigeria gets educational concessions from IOCs, and many American oil companies send Nigerians to American universities to become a petroleum engineers. The UAE also began its international petroleum institute with support from international universities and oil companies.[156] These types of measures will begin to put the Iraqi economy on more stable ground after nearly a decade of war and make it more likely that Iraqi citizens benefit from Iraq's vast oil wealth via employment opportunities.

Focusing on local knowledge transfer and transparency initiatives are important ways to ensure that Iraq benefits from its vast oil reserves. These are small, relatively uncontroversial steps when compared to solving the Kirkuk issue or passing hydrocarbons legislation that has been stalled for over four years. More importantly, both sides can pursue these avenues (transparency and local knowledge transfer) while still pursuing their own oil production paths. It is likely that the KRG and central governments will continue to develop their own approaches, each side counting on faits accomplis to legitimize their contracts and thus their understanding of the balance of power between Iraq's center and periphery. This bifurcated approach may result in the unbundling of the INOC into more independent component parts, with a privatized North Oil Company (see Figure 16 in Appendix C).

Iraq's weak governance does not bode well for a comprehensive negotiated settlement in the near-term future. The current stalemate and could even deteriorate into

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[156] Marcel 247. See also The Petroleum Institute. "Partners and Sponsors." http://www.pi.ac.ae/PI_INS/eo/info/partners.php (Accessed May 4, 2011).

political or violent conflict over the long term if the federal government either shuts the KRG out from receiving a fair share of Iraq's oil proceeds or prevents the KRG from growing its own oil industry. Unfortunately, the case studies show that protracted civil conflict is often a precursor to achieving a comprehensive negotiated settlement; however, Iraq's newly elected parliament has prioritized hydrocarbons legislation, so the country may ultimately pursue a peaceful path to ensure equitable distribution of its oil wealth among all groups.[157]

[157] Lando "Q&A with Adnan Jalabi."

Appendices

Appendix A: List of abbreviations

ADNOC – Abu Dhabi National Oil Company

CPA – Coalition Provisional Authority

CPA (Sudan, Chapter 2) – Comprehensive Peace Agreement

DFID – Department for International Development

EITI – Extractive Industry Transparency Initiative

FOGC – Federal Oil and Gas Council

GAM – Free Aceh Movement

ICG – International Crisis Group

INOC – Iraq National Oil Company

IOC – International Oil Company

ISCI – Islamic Supreme Council of Iraq

KRG – Kurdistan Regional Government

KDP – Kurdish Democratic Party

MENA – Middle East North Africa

NOC – National Oil Company

PSA – Production Sharing Agreement

PUK – Patriotic Union of Kurdistan

PWYP – Publish what you pay

SOMO – State Oil Marketing Organization

SPLM – Sudan People's Liberation Movement

TAL – Transitional Administrative Law

UAE – United Arab Emirates

APPENDIX B: SELECTED ARTICLES OF THE 2005 IRAQI CONSTITUTION

Article 110

The federal government shall have exclusive authorities in the following matters:

<u>First</u>: Formulating foreign policy and diplomatic representation; negotiating, signing, and ratifying international treaties and agreements; negotiating, signing, and ratifying debt policies and formulating foreign sovereign economic and trade policy.

<u>Second</u>: Formulating and executing national security policy, including establishing and managing armed forces to secure the protection and guarantee the security of Iraq's borders and to defend Iraq.

<u>Third</u>: Formulating fiscal and customs policy; issuing currency; regulating commercial policy across regional and governorate boundaries in Iraq; drawing up the national budget of the State; formulating monetary policy; and establishing and administering a central bank.

<u>Fourth</u>: Regulating standards, weights, and measures.

Fifth: Regulating issues of citizenship, naturalization, residency, and the right to apply for political asylum.

<u>Sixth</u>: Regulating the policies of broadcast frequencies and mail.

<u>Seventh</u>: Drawing up the general and investment budget bill.

<u>Eighth</u>: Planning policies relating to water sources from outside Iraq and guaranteeing the rate of water flow to Iraq and its just distribution inside Iraq in accordance with international laws and conventions.

<u>Ninth</u>: General population statistics and census.

Article 111

Oil and gas are owned by all the people of Iraq in all the regions and governorates

Article 112

First: The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields, provided that it distributes its revenues in a fair manner in proportion to the population distribution in all parts of the country, specifying an allotment for a specified period for the damaged regions which were unjustly deprived of them by the former regime, and the regions that were damaged afterwards in a way that ensures balanced development in different areas of the country, and this shall be regulated by a law.

Second: The federal government, with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment.

Article 115

All powers not stipulated in the exclusive powers of the federal government belong to the authorities of the regions and governorates that are not organized in a region. With regard to other powers shared between the federal government and the regional government, priority shall be given to the law of the regions and governorates not organized in a region in case of dispute.

Article 121

First: The regional powers shall have the right to exercise executive, legislative, and judicial powers in accordance with this Constitution, except for those authorities stipulated in the exclusive authorities of the federal government.

Second: In case of a contradiction between regional and national legislation in respect to a matter outside the exclusive authorities of the federal government, the regional power shall have the right to amend the application of the national legislation within that region.

Third: Regions and governorates shall be allocated an equitable share of the national revenues sufficient to discharge their responsibilities and duties, but having regard to their resources, needs, and the percentage of their population.

Fourth: Offices for the regions and governorates shall be established in embassies and diplomatic missions, in order to follow cultural, social, and developmental affairs.

Fifth: The regional government shall be responsible for all the administrative requirements of the region, particularly the establishment and organization of the internal security forces for the region such as police, security forces, and guards of the region.

Article 140

First: The executive authority shall undertake the necessary steps to complete the implementation of the requirements of all subparagraphs of Article 58 of the Transitional Administrative Law.

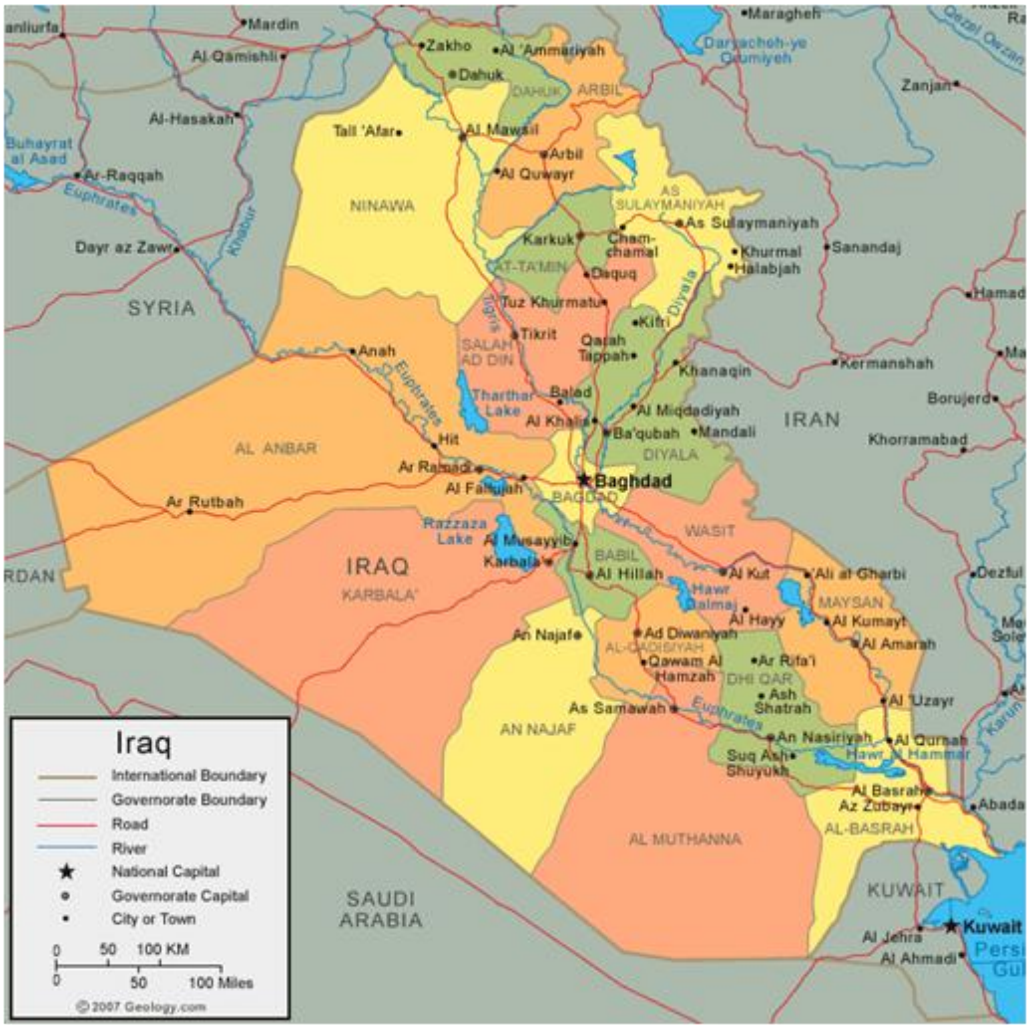
Second: The responsibility placed upon the executive branch of the Iraqi Transitional Government stipulated in Article 58 of the Transitional Administrative Law shall extend and continue to the executive authority elected in accordance with this Constitution, provided that it accomplishes completely (normalization and census and concludes with a referendum in Kirkuk and other disputed territories to determine the will of their citizens), by a date not to exceed the 31st of December 2007.

Article 141

Legislation enacted in the region of Kurdistan since 1992 shall remain in force, and decisions issued by the government of the region of Kurdistan, including court decisions and contracts, shall be considered valid unless they are amended or annulled pursuant to the laws of the region of Kurdistan by the competent entity in the region, provided that they do not contradict with the Constitution.

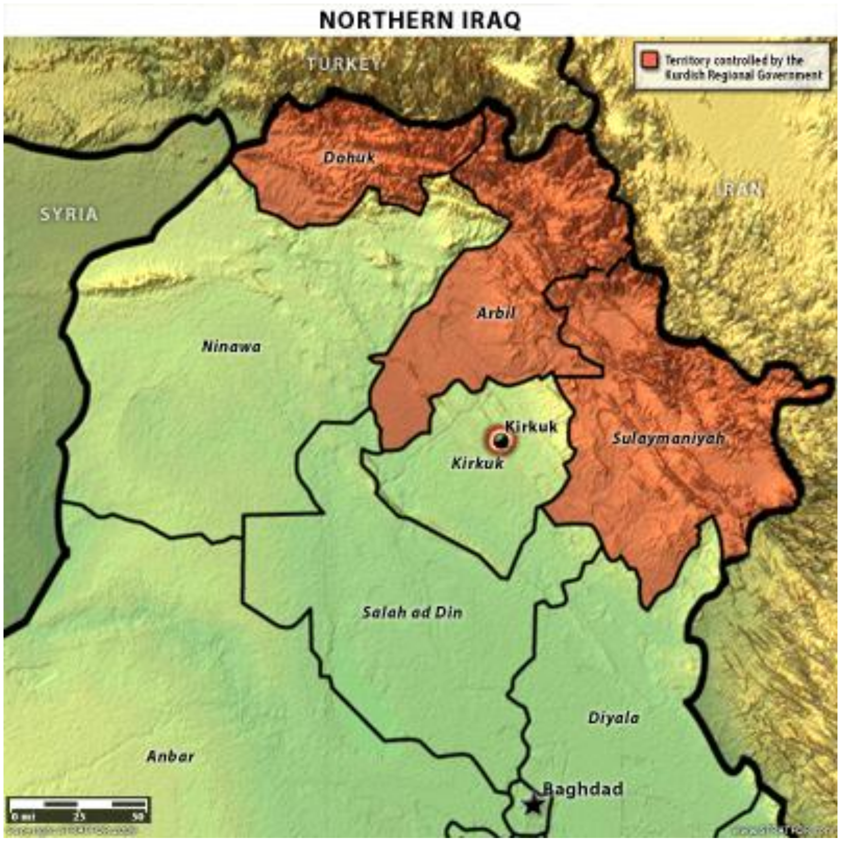
APPENDIX C: MAPS

Figure 1: Political map of Iraq by governorate[158]



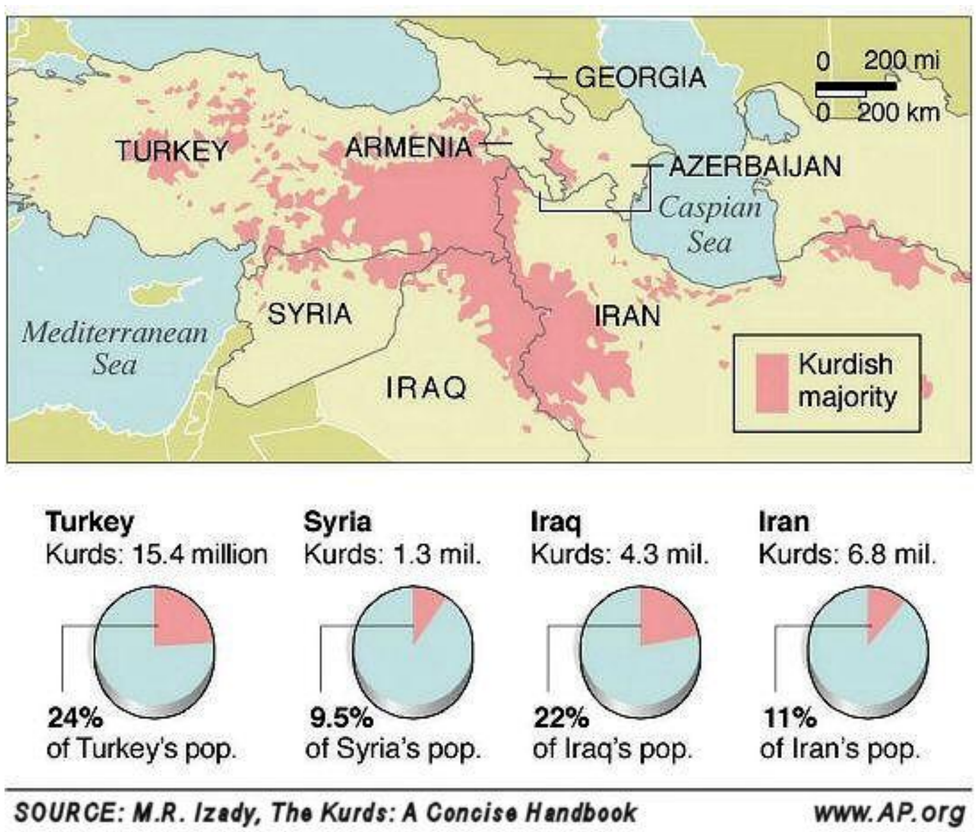
158 Printable-maps.blogspot.com

Figure 2: Map of the Kurdish Regional Governorate[159]



159 Stratfor.com

Figure 3: Map of Kurdish-inhabited areas[160]



160 From Izady, Merhdad R. "The Kurds: a concise handbook." Washington, D.C.: Taylor & Francis, 1992.

Figure 4: Linguistic break-down of Kurdish speakers[161]

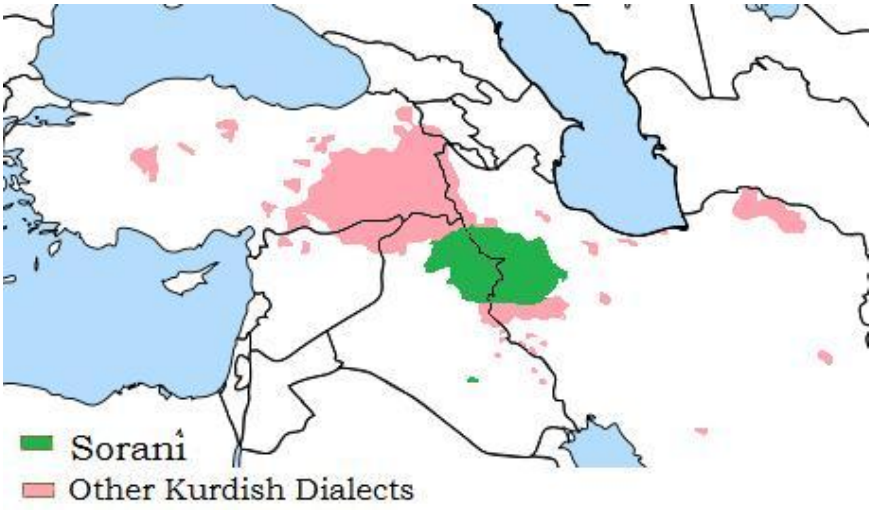


Figure 5: Disputed territories[162]

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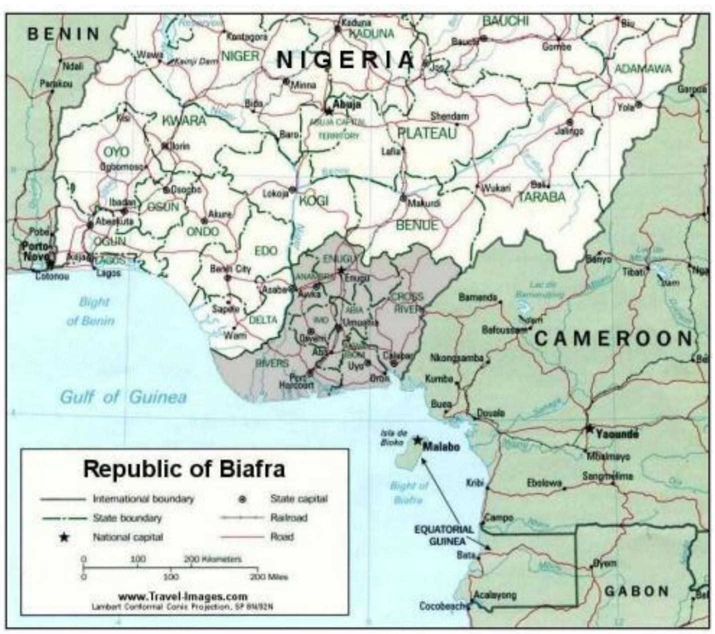
161 http://en.wikipedia.org/wiki/File:Dialects.jpg

162 National Geographic

Figure 6: Nigerian oil fields[163]

Figure 7: Republic of Biafra (1967-1970)



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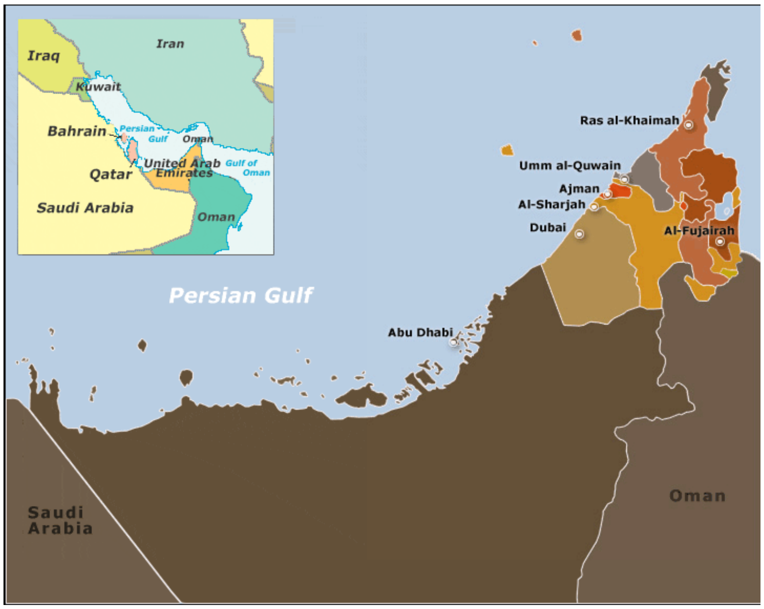
163 Nairaland.com

Figure 8: North and South Sudan with oil fields[164]

164 Economist.com

Figure 9: Political map of the United Arab Emirates[165]



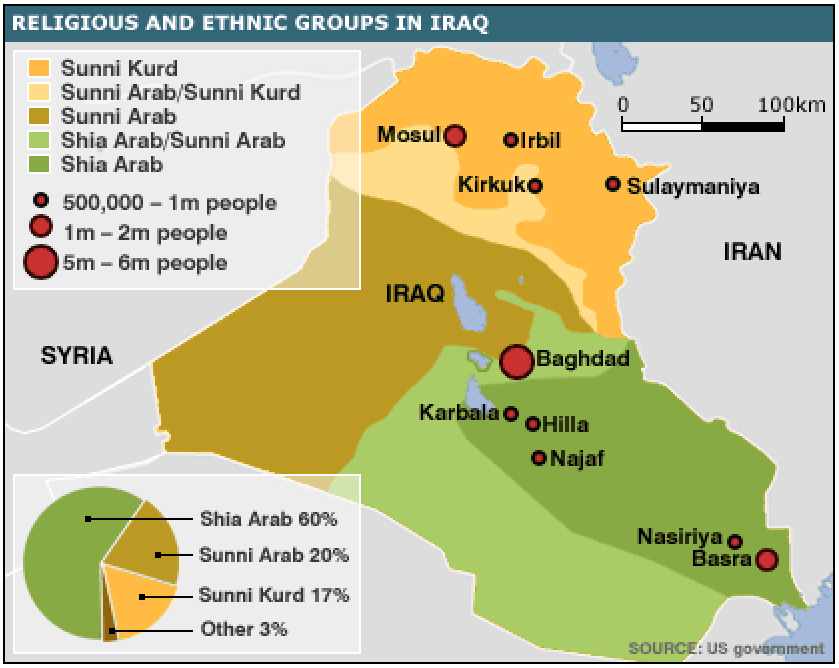
165 Pbs.org

Figure 10: Map of oil fields in the UAE[166]

Figure 11: Indonesia[167]

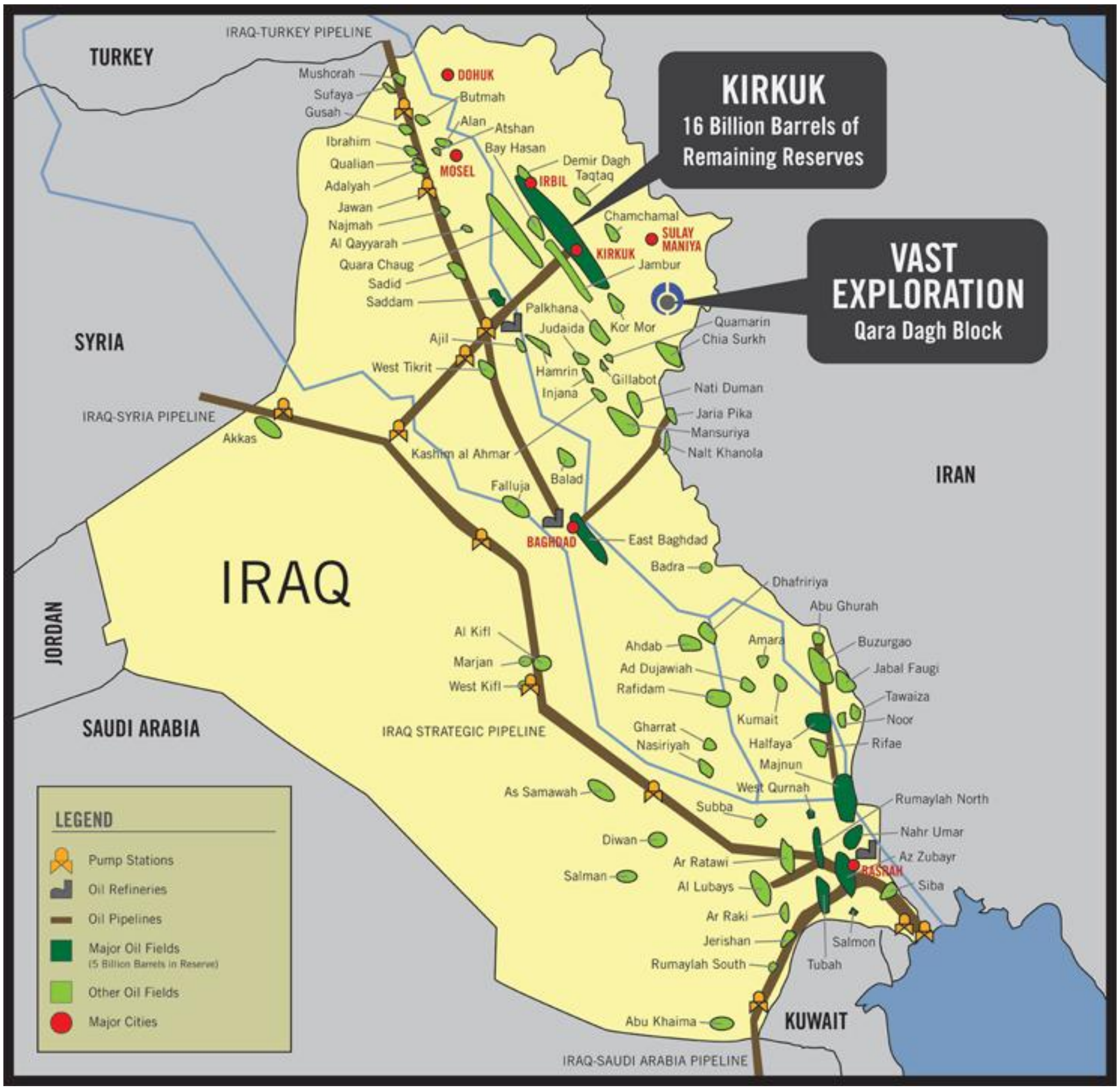
166 Paleopolis.rediris.es
167 News.bbc.co.uk

Figure 12: Religious and ethnic groups in Iraq[168]



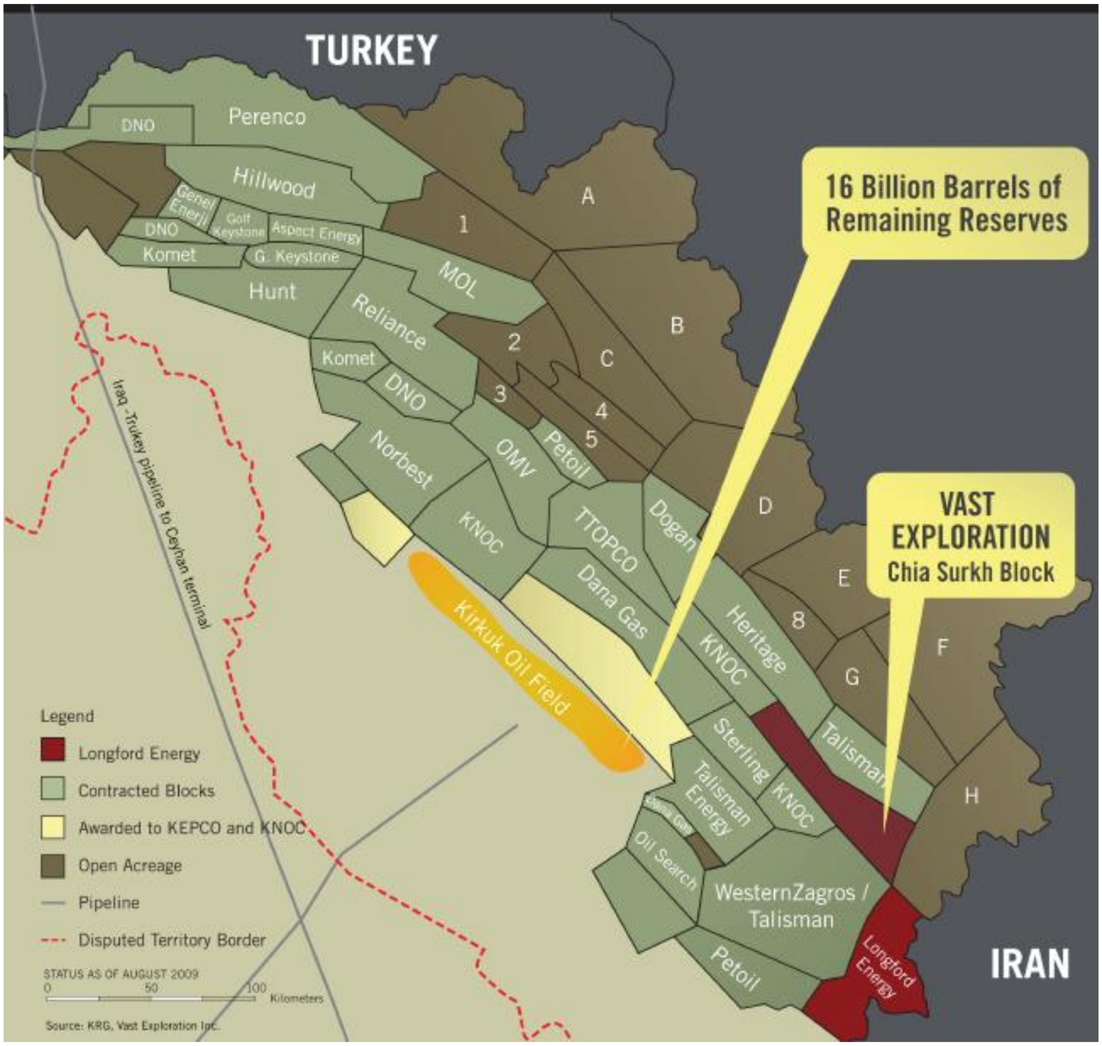
[168] News.bbc.co.uk "Life in Iraq: People"

Figure 13: Iraqi oil fields and pipelines[169]



169 Vast Exploration

Figure 14: KRG oil fields[170]



170 Vast Exploration

Figure 15: Ceyhan export pipeline

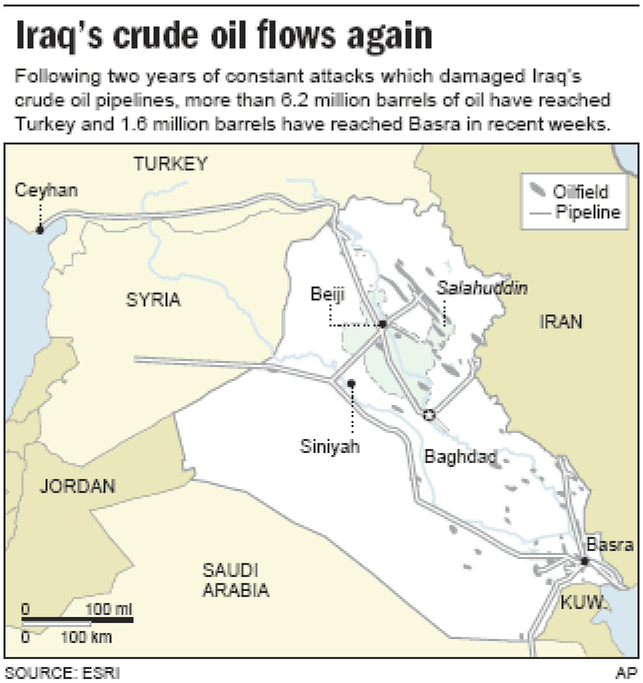
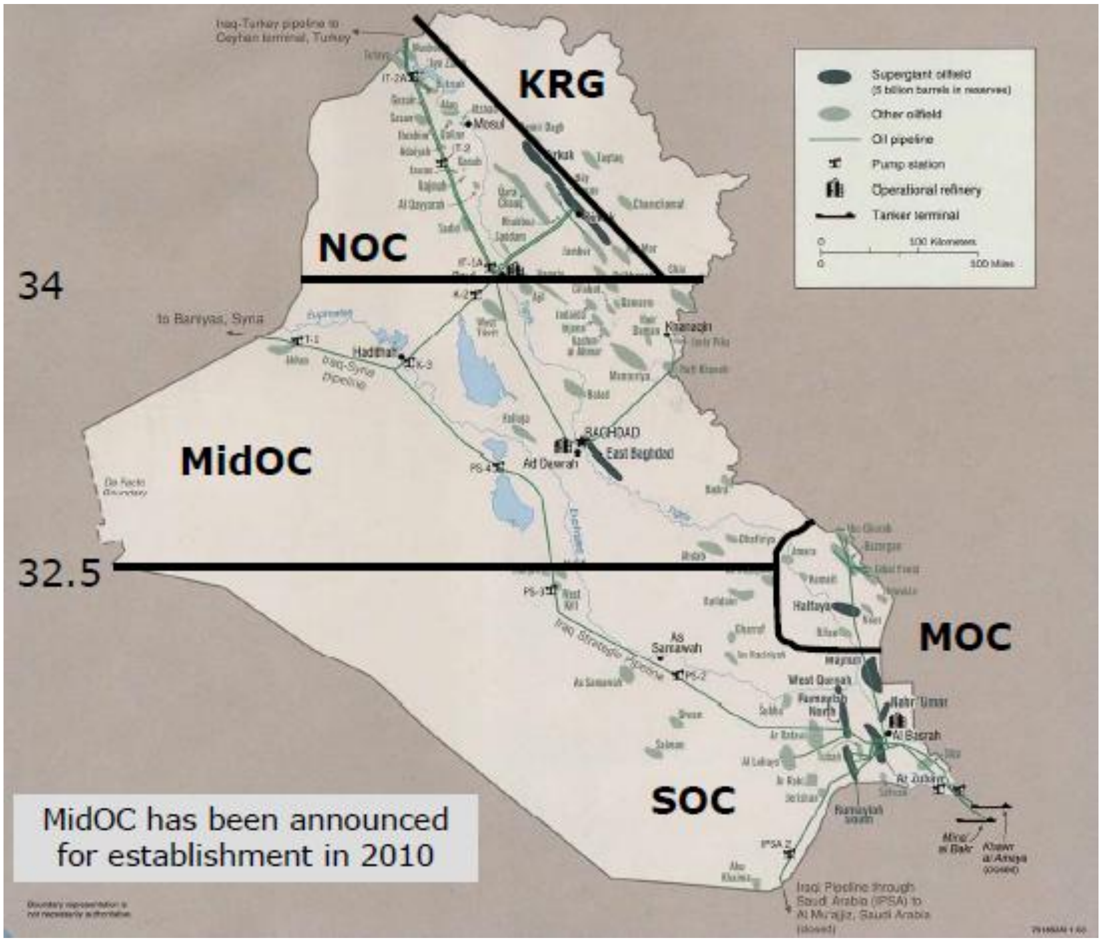


Figure 16: Iraqi Oil Operating Unit Areas[171]



[171] Lydecker, slide 17.

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